The Financial Crisis and the Future of the P/C Insurance Industry

Challenges & Opportunities Amid the Economic Storm

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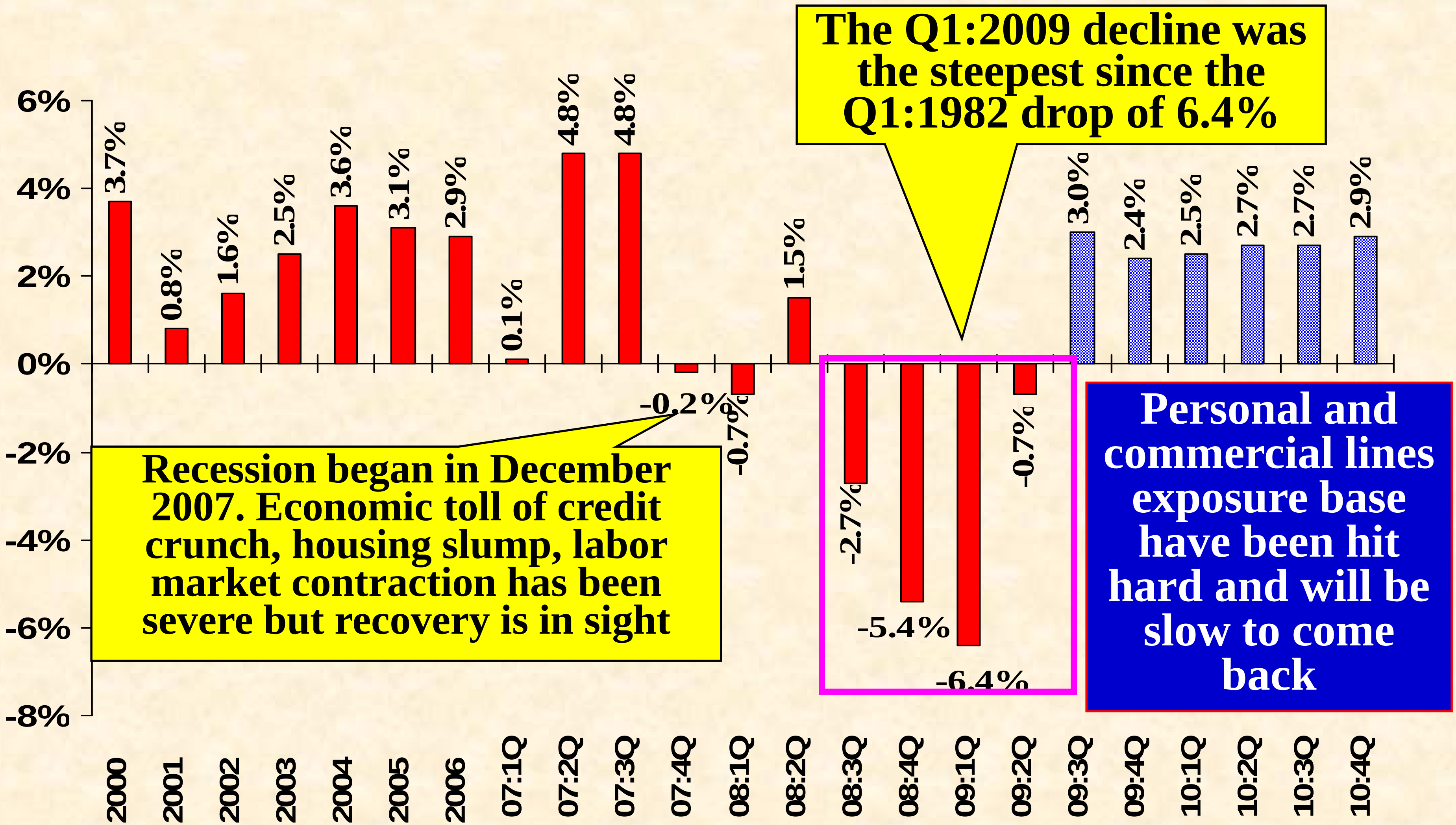
Presentation Outline

- The Economic Storm: Financial Crisis & Recession
  - Exposure & Growth: Regional Analysis
- Economic Trends: Commercial, Personal Implications
- Key Threats and Issues Facing P/C Insurers Through 2015
- Regulatory Reform
- Financial Strength & Ratings
  - Key Differences Between Insurer and Bank Performance During Crisis
- Insurance Industry Financial Overview & Outlook
  - Profitability
  - Premium Growth
  - Underwriting Performance: Commercial & Personal Lines
  - Financial Market Impacts
  - Merger & Acquisition Activity
- Capital & Capacity
- Catastrophe Loss Trends

THE ECONOMIC STORM

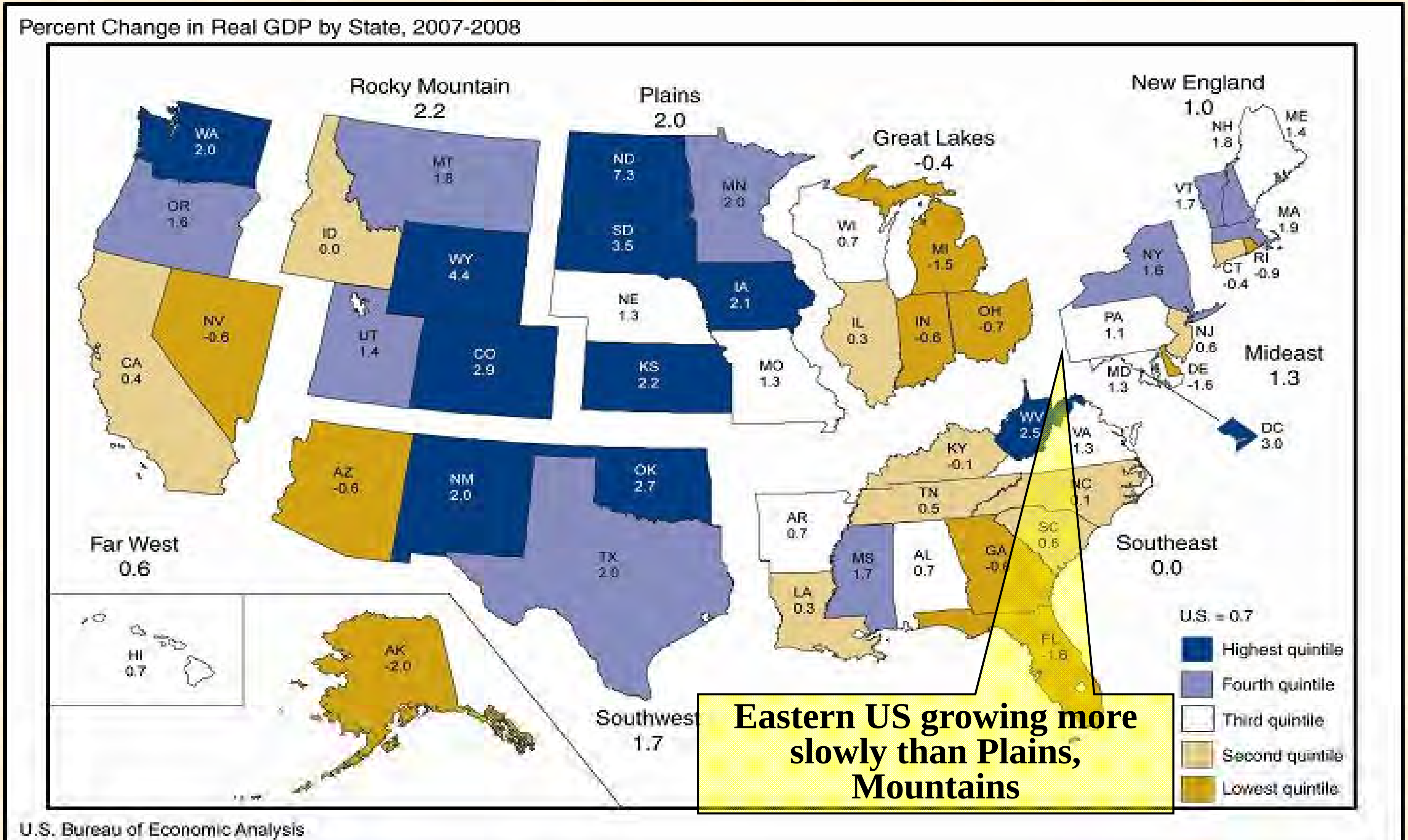
What the Financial Crisis and Recession Mean for the Industry's Exposure Base, Growth and Investments

*Real GDP Growth**

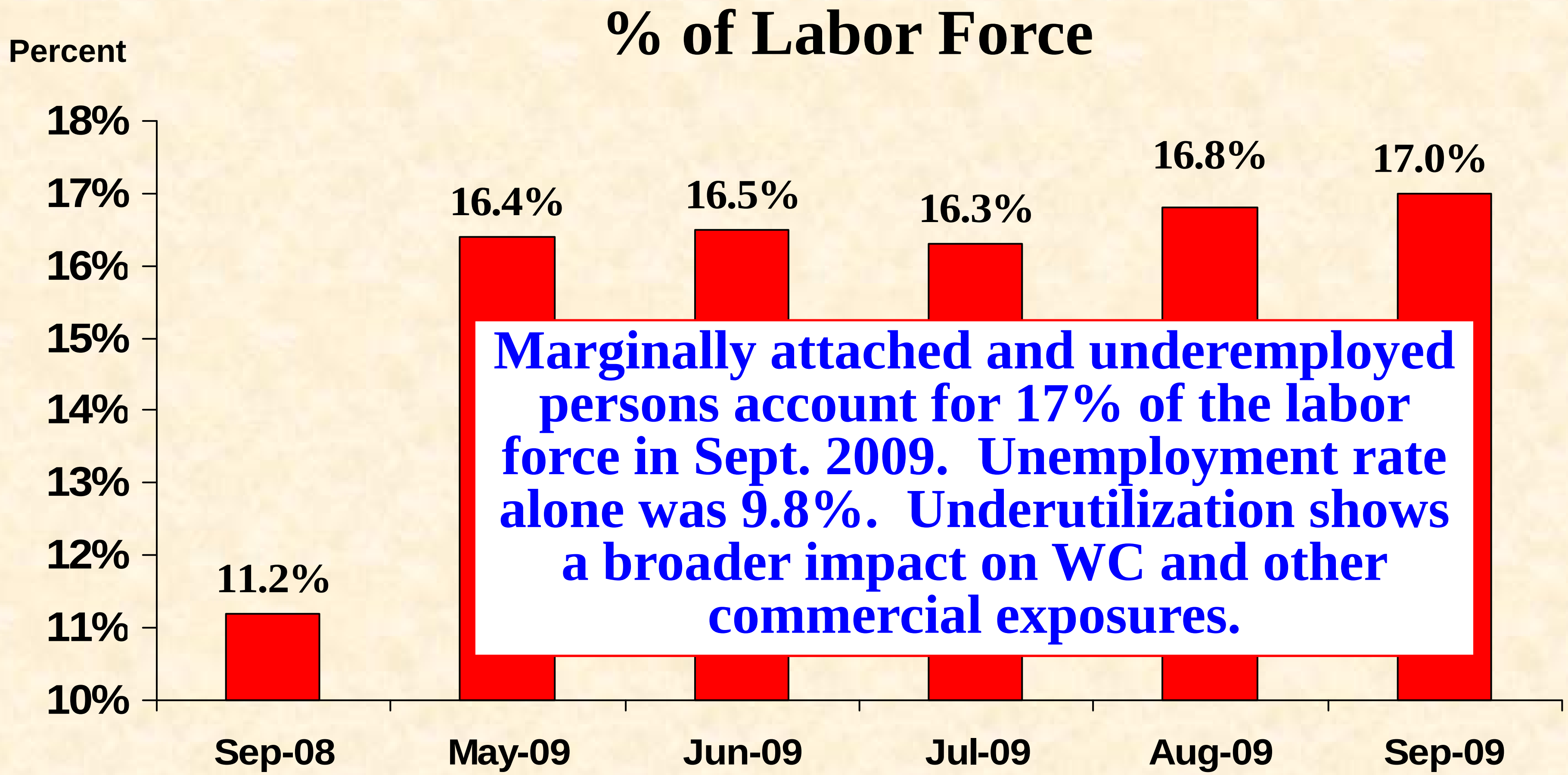


***Blue bars are Estimates/Forecasts from Blue Chip Economic Indicators.**
Source: US Department of Commerce, Blue Economic Indicators 9/09; Insurance Information Institute.

State Economic Growth Varied Tremendously in 2008



Labor Underutilization: Broader than Just Unemployment

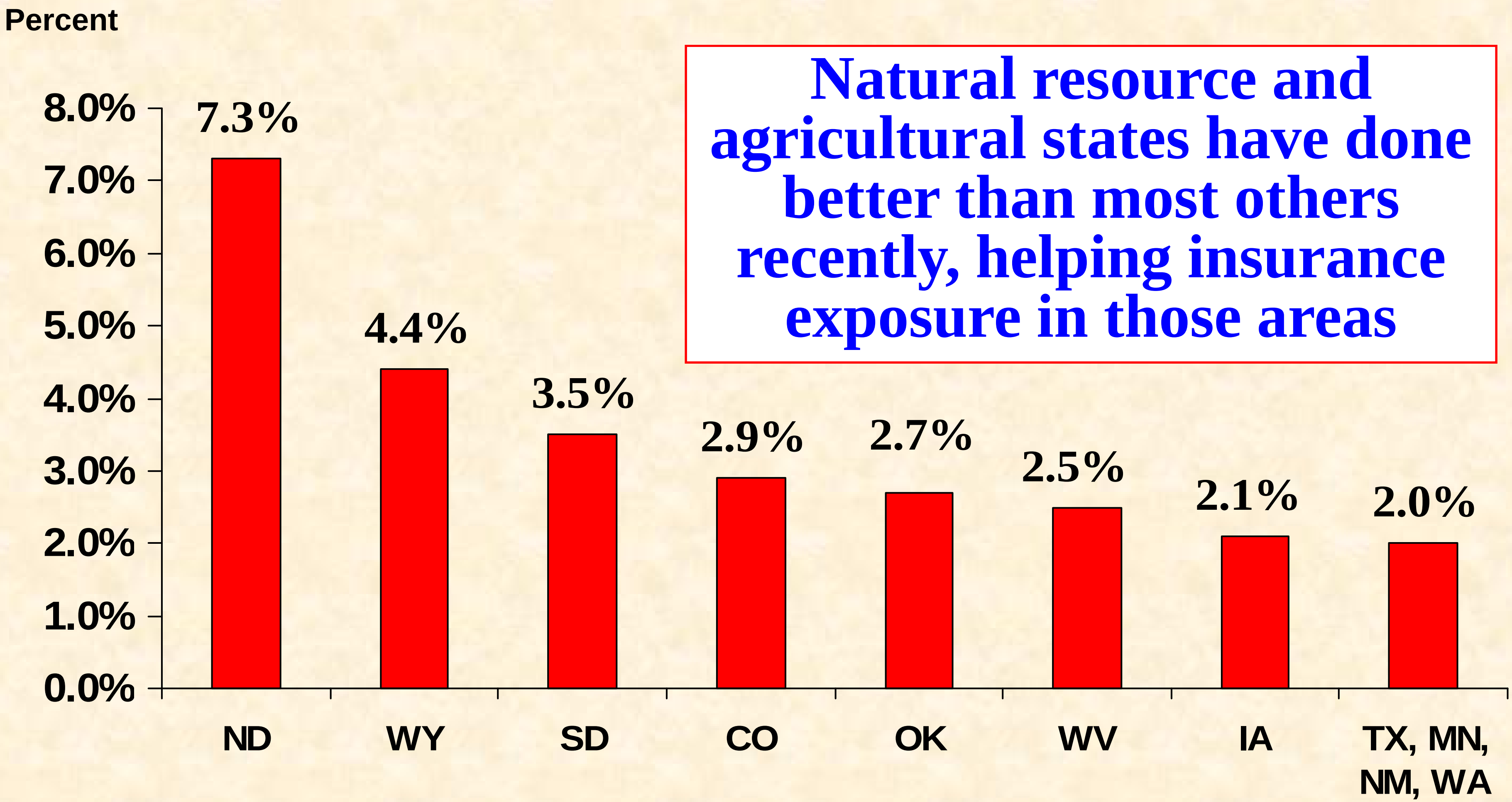


NOTE: Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available For a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not looking currently for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule.

Source: US Bureau of Labor Statistics; Insurance Information Institute.

Fastest Growing States in 2008: Plains, Mountain States Lead

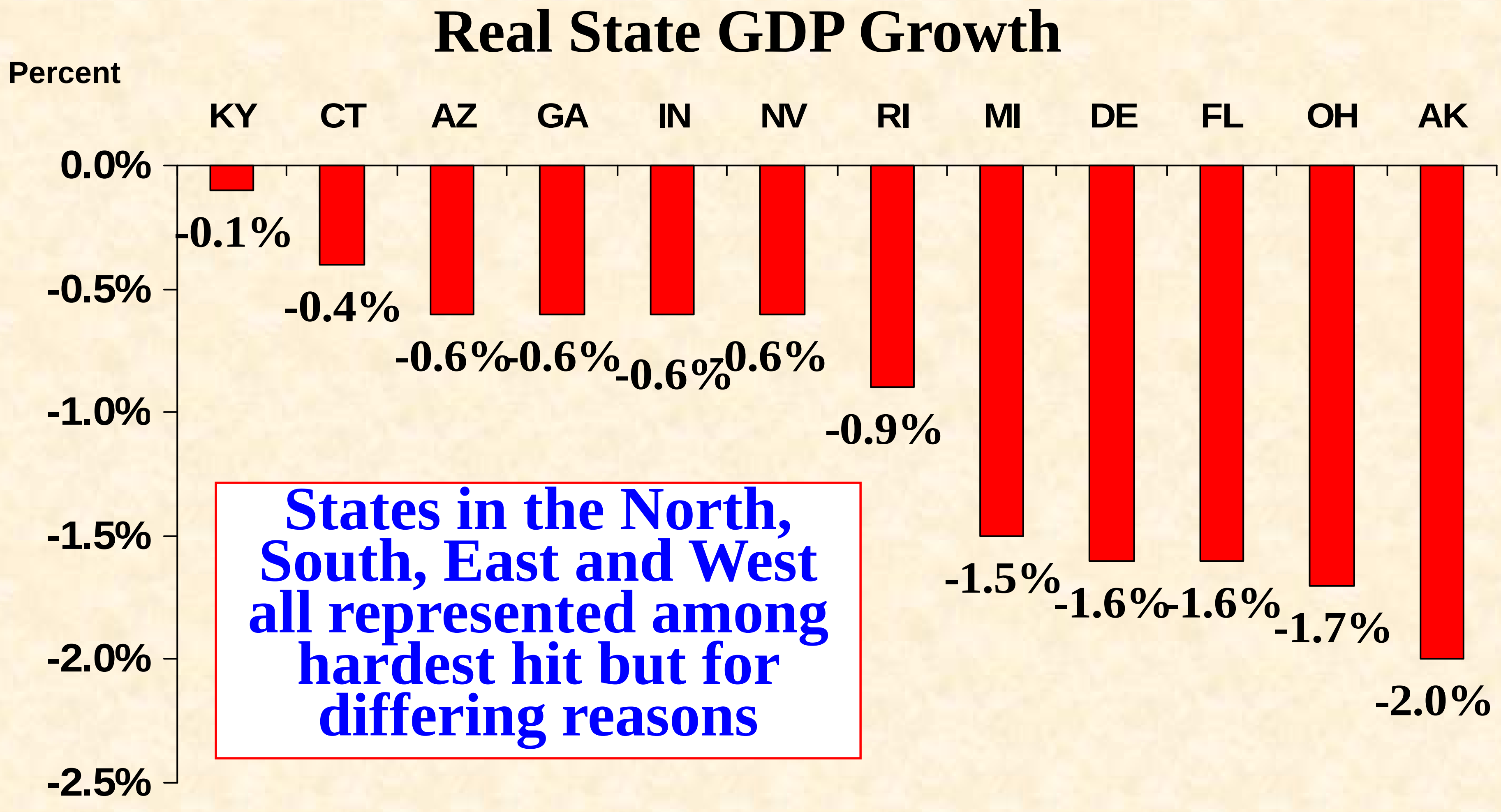
Real State GDP Growth



Natural resource and agricultural states have done better than most others recently, helping insurance exposure in those areas

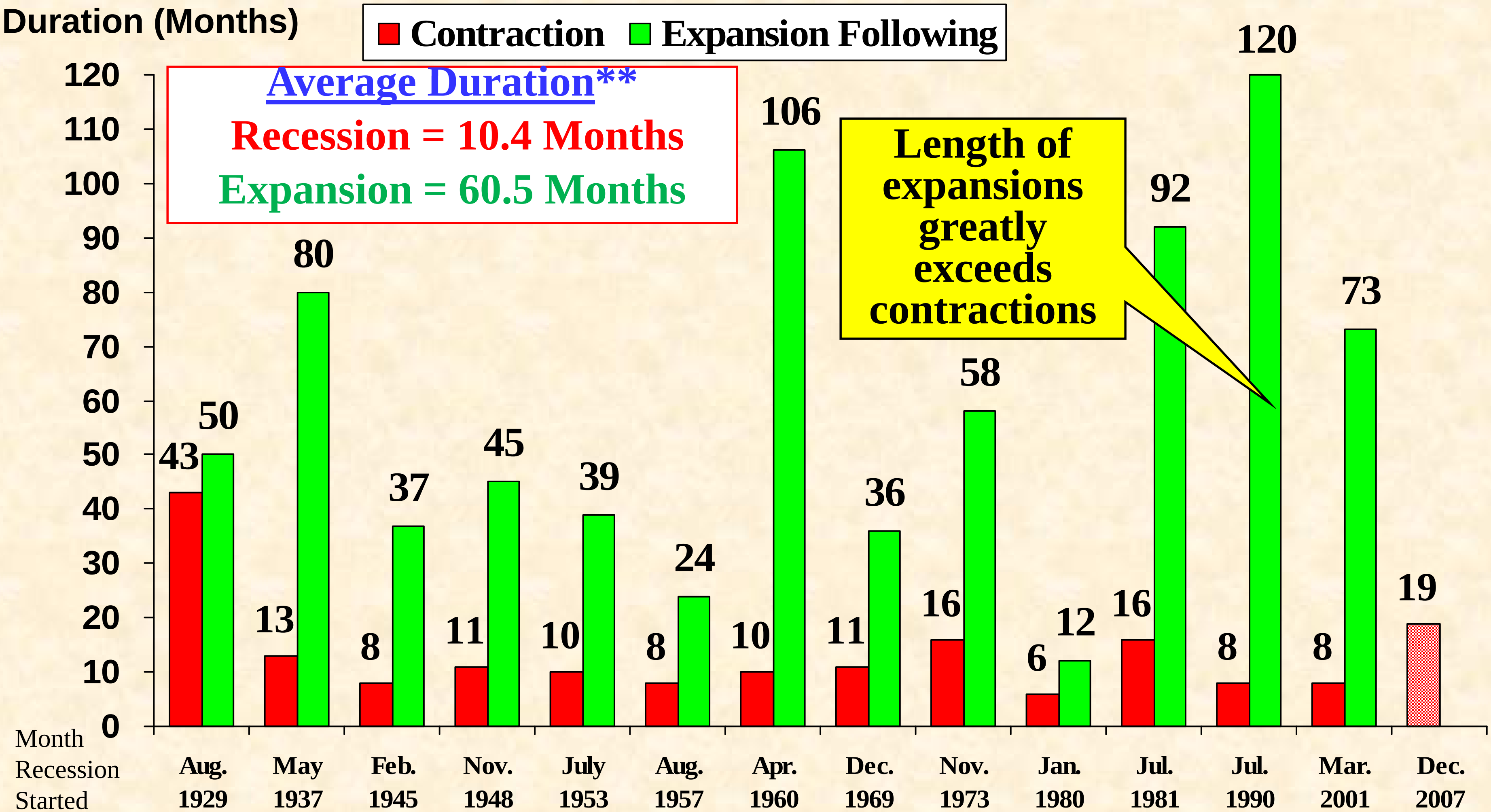
Source: US Bureau of Economic Analysis; Insurance Information Institute.

Slowest Growing States in 2008: Diversity of States Suffering



Source: US Bureau of Economic Analysis; Insurance Information Institute.

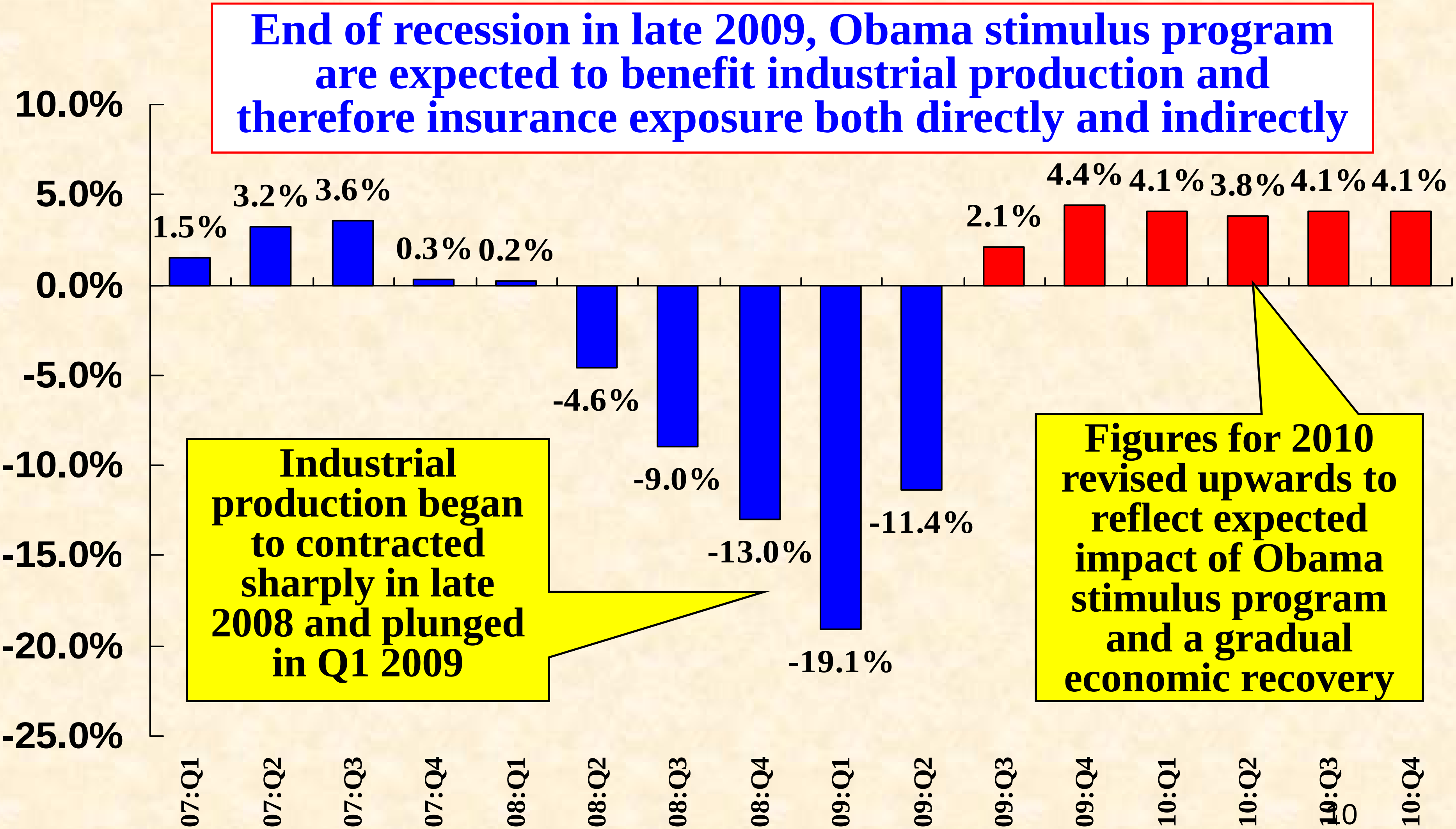
Length of U.S. Business Cycles, 1929-Present*



* Through June 2009 (likely the "official end" of recession) **Post-WW II period through end of most recent expansion.

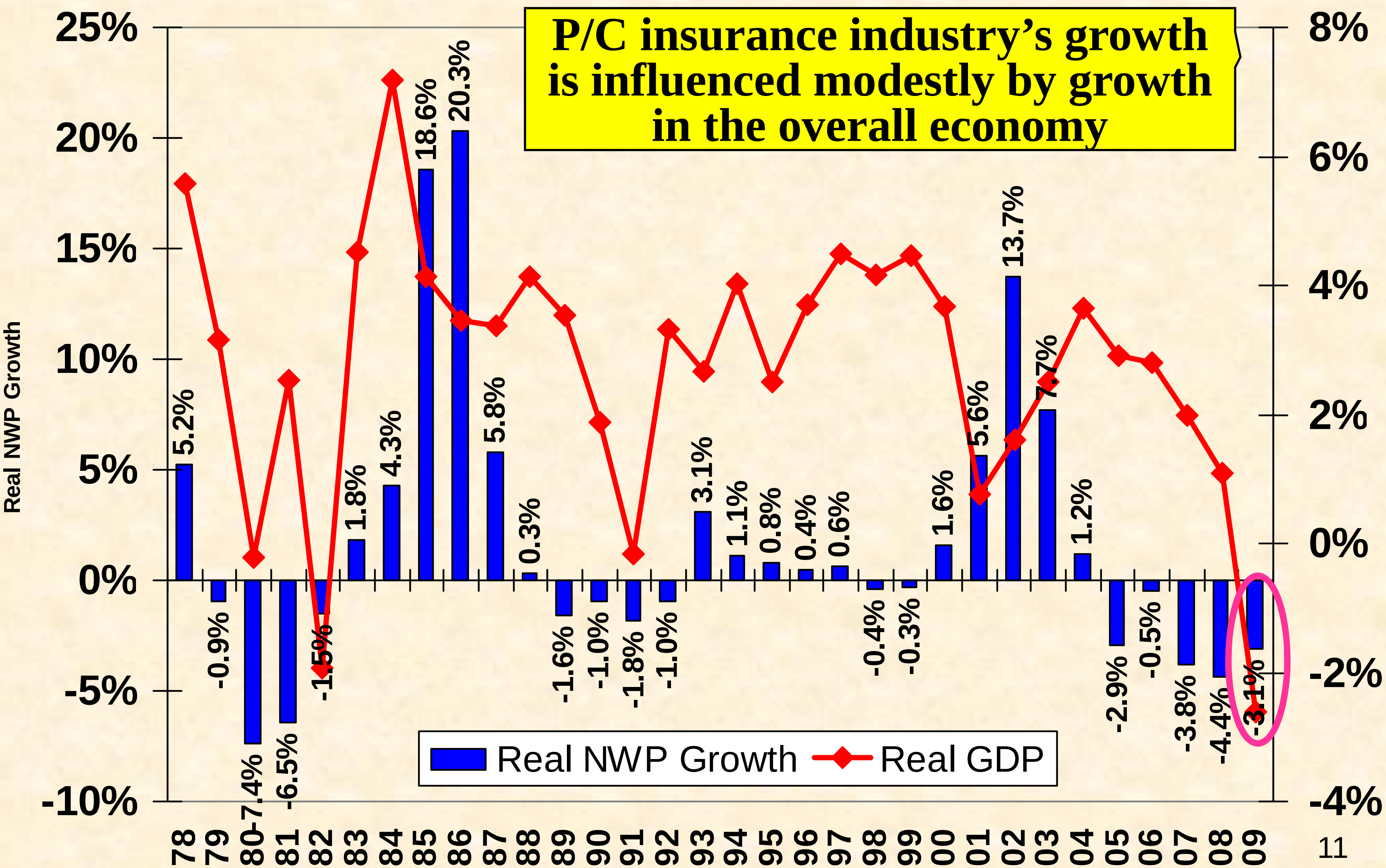
Sources: National Bureau of Economic Research; Insurance Information Institute.

Total Industrial Production, (2007:Q1 to 2010:Q4F)



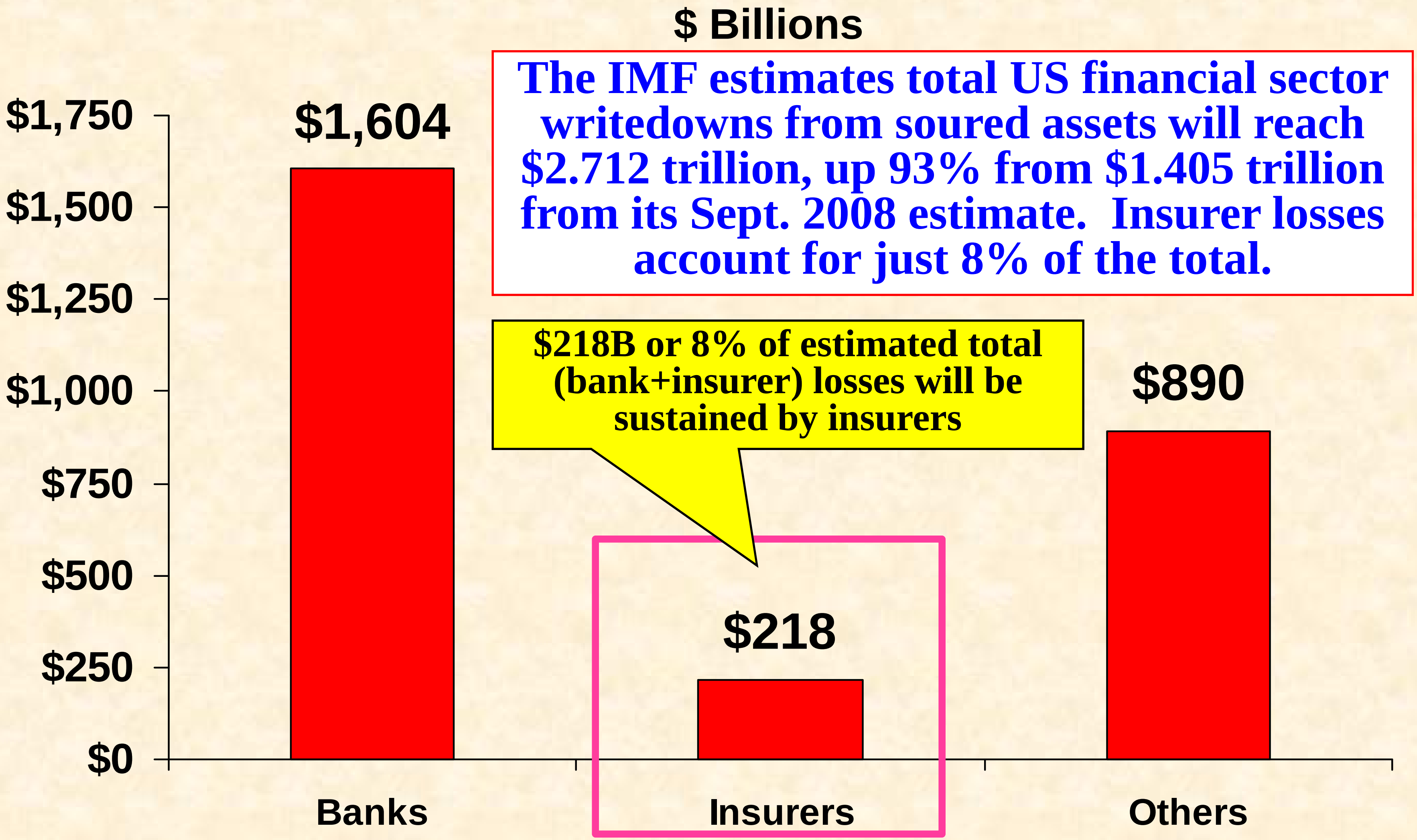
Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (9/09); Insurance Info. Inst.

Real GDP Growth vs. Real P/C Premium Growth: Modest Association



Sources: A.M. Best, US Bureau of Economic Analysis, Blue Chip Economic Indicators, 9/09; Insurance Information Inst.

US Financial Institutions Facing Huge Losses from Financial Crisis*



The IMF estimates total US financial sector writedowns from soured assets will reach $2.712 trillion, up 93% from $1.405 trillion from its Sept. 2008 estimate. Insurer losses account for just 8% of the total.

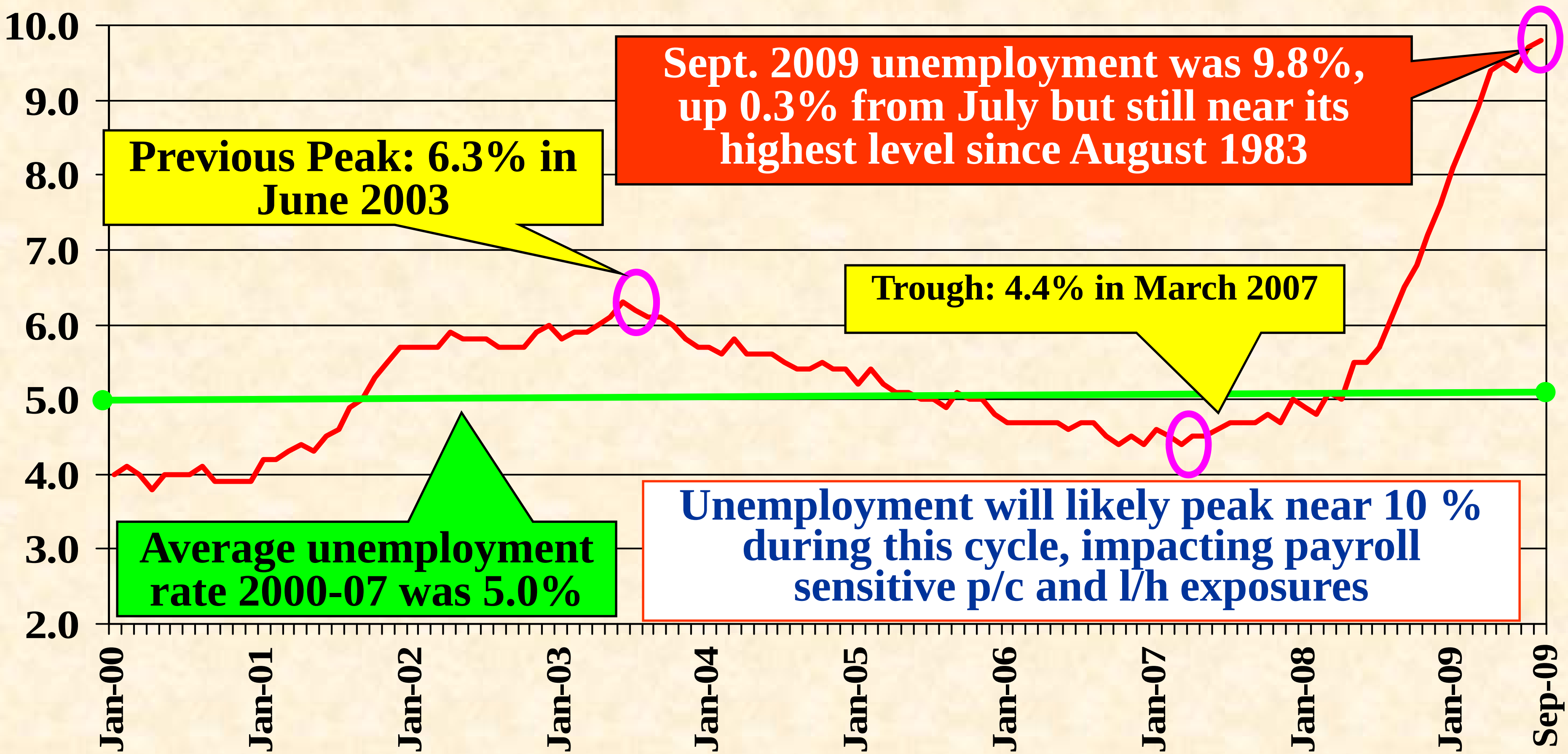
*Estimate of financial sector writedowns, 2007-2010, as of April 2009. Includes loans and securities.
Source: IMF Global Financial Stability Report, April 2009.

Labor Market Trends

Fast & Furious: Massive Job Losses Sap the Economy & Personal & Commercial Lines Exposure

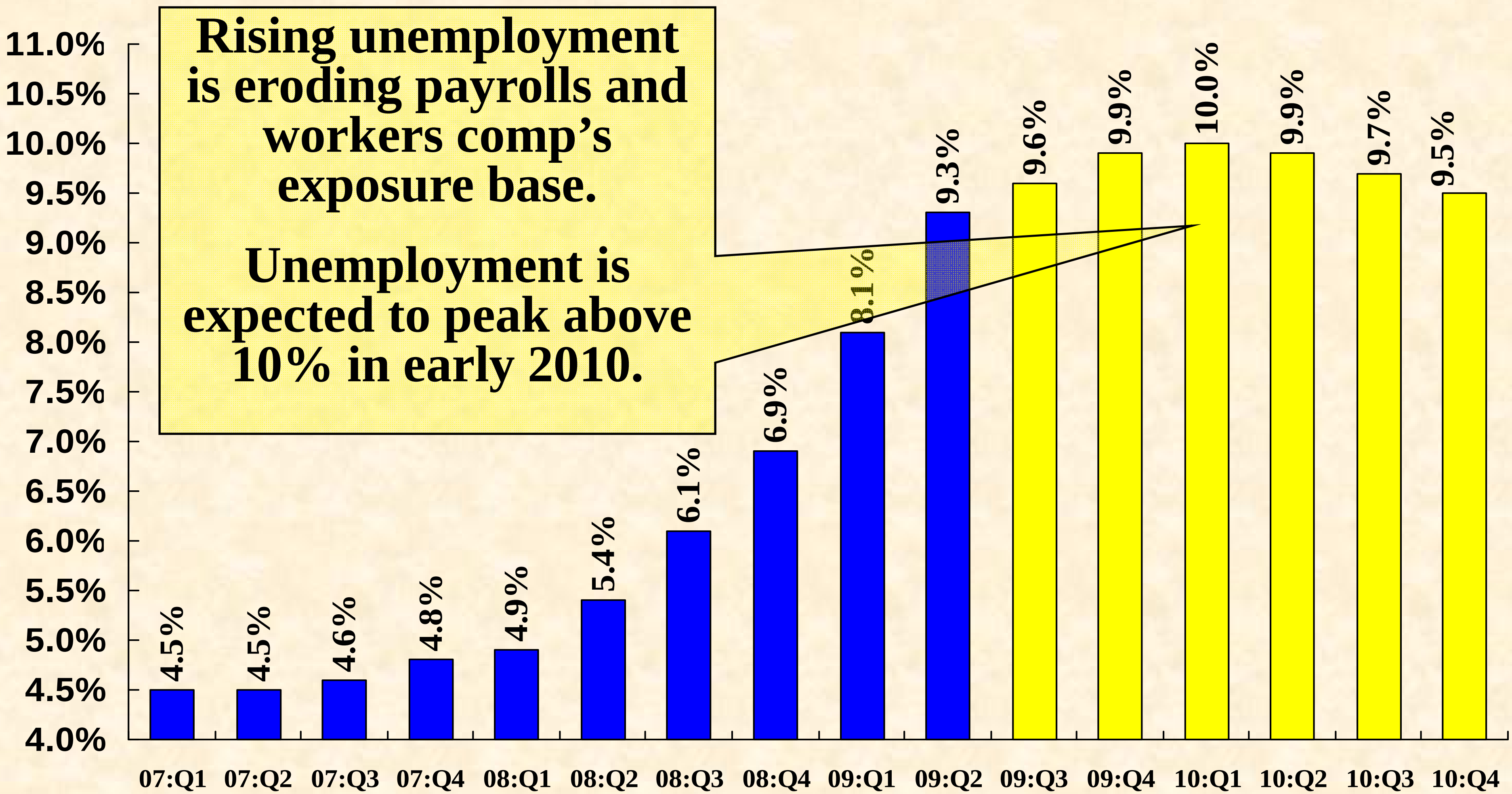
Unemployment Rate: On the Rise

January 2000 through September 2009*



Source: US Bureau of Labor Statistics; Insurance Information Institute.

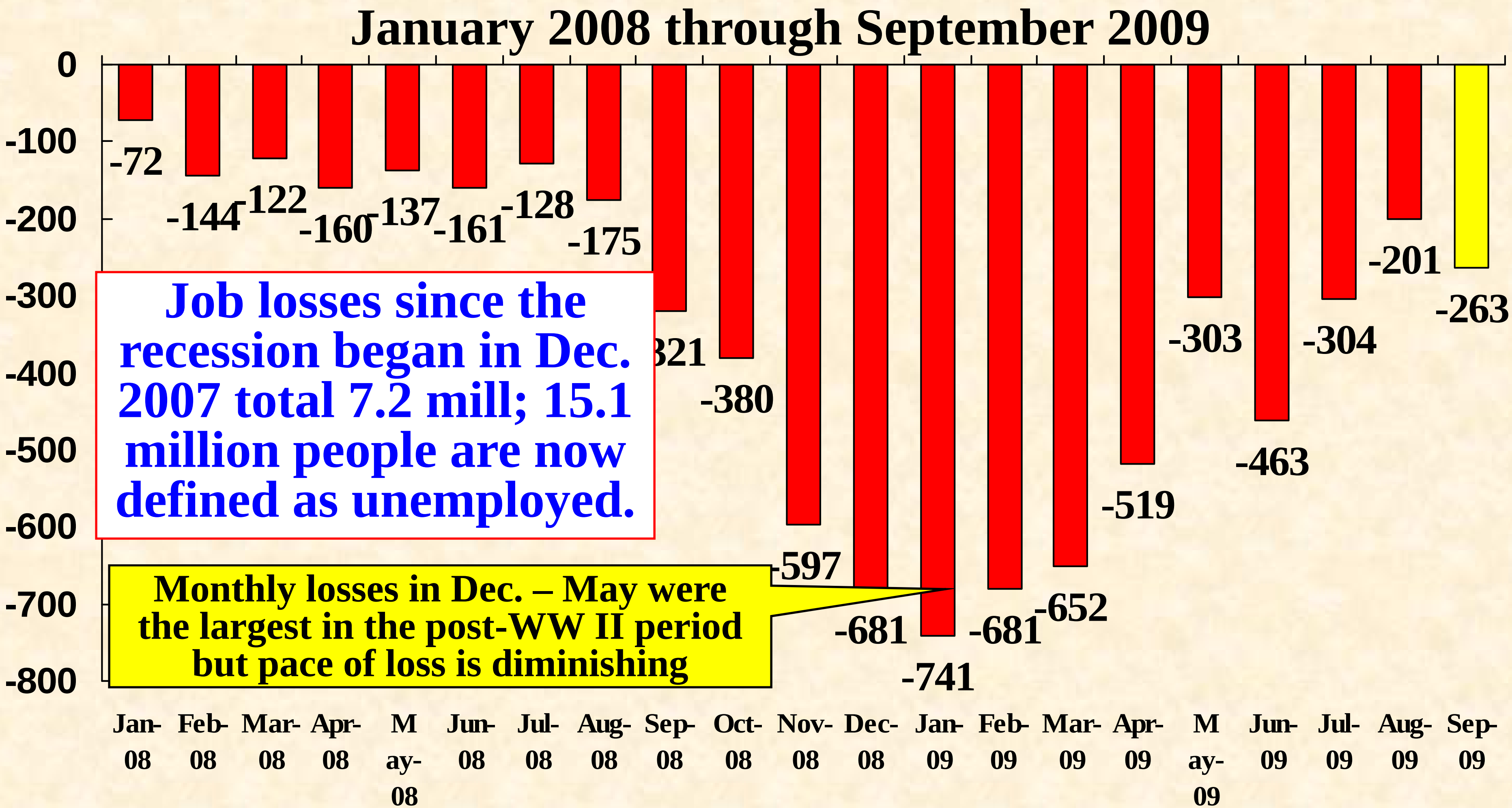
U.S. Unemployment Rate, (2007:Q1 to 2010:Q4F)*



* Blue bars are actual; Yellow bars are forecasts

Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators (9/09); Insurance Info. Inst.

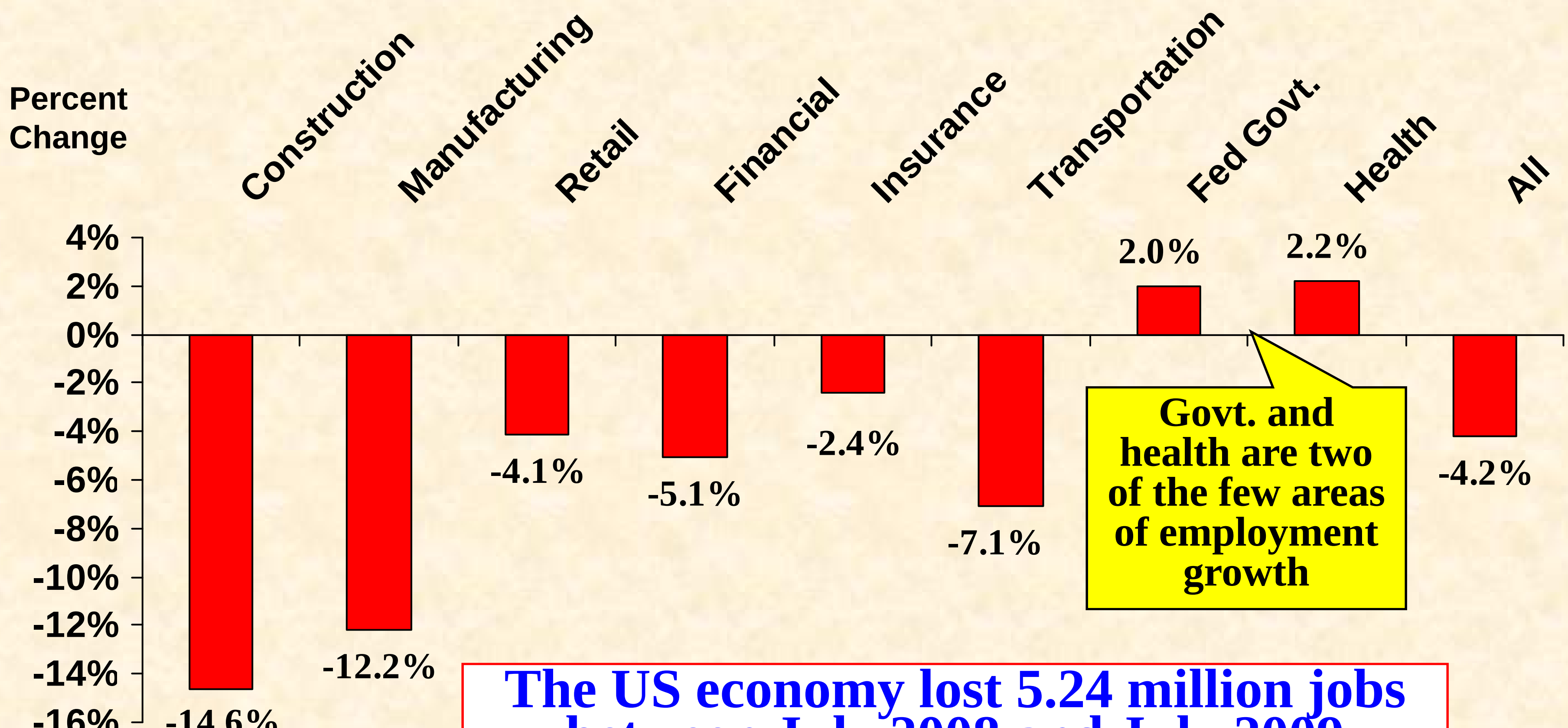
Monthly Change Employment* (Thousands)



Source: US Bureau of Labor Statistics: http://www.bls.gov/ces/home.htm; Insurance Info. Institute

% Change in Employment by Industry: All But Government/Health Down

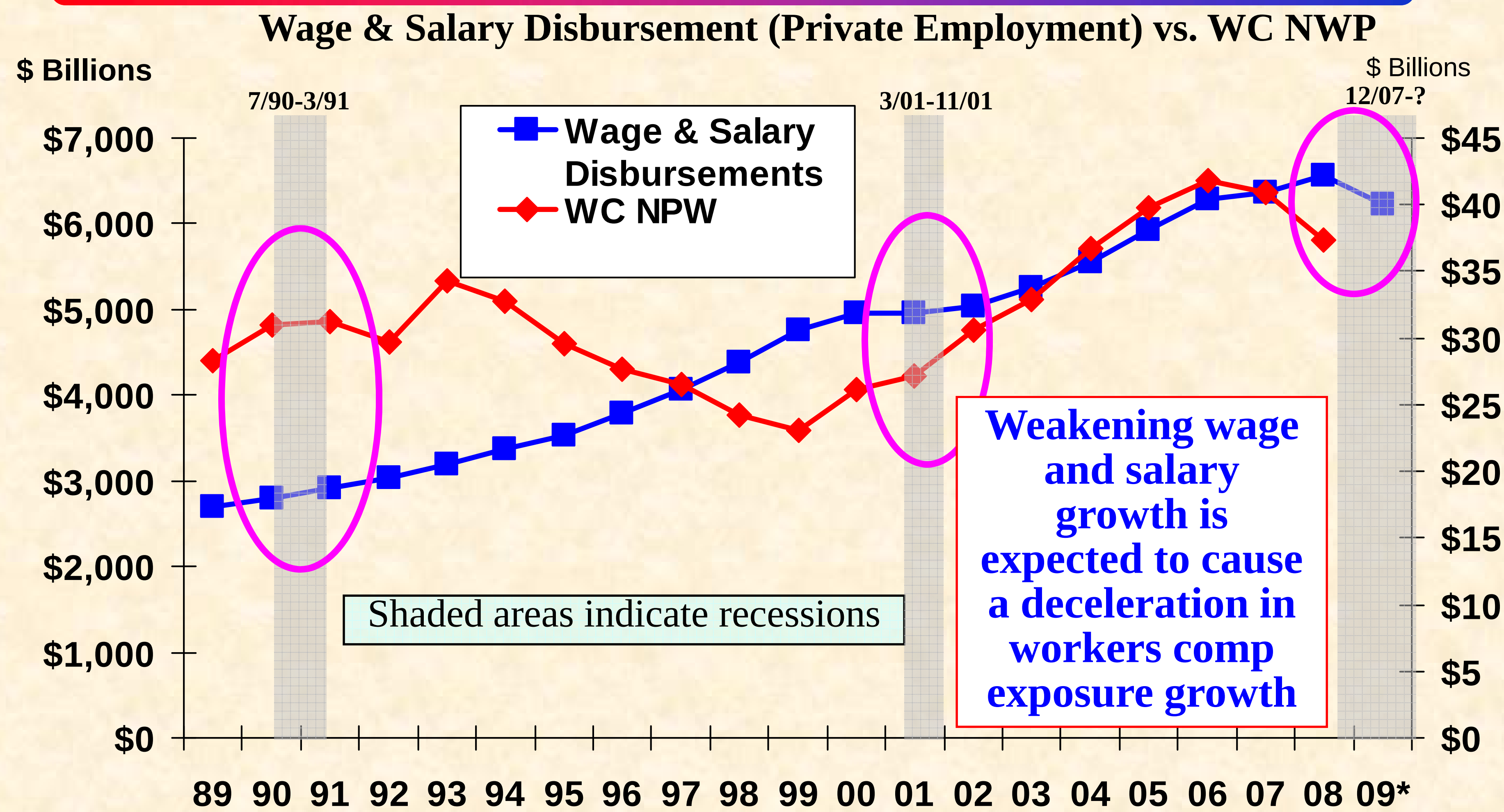
Change in July 2009 vs. July 2008



The US economy lost 5.24 million jobs between July 2008 and July 2009

Source: US Bureau of Labor Statistics http://www.bls.gov/news.release/empsit.t14.htm; Ins. Info. Institute.

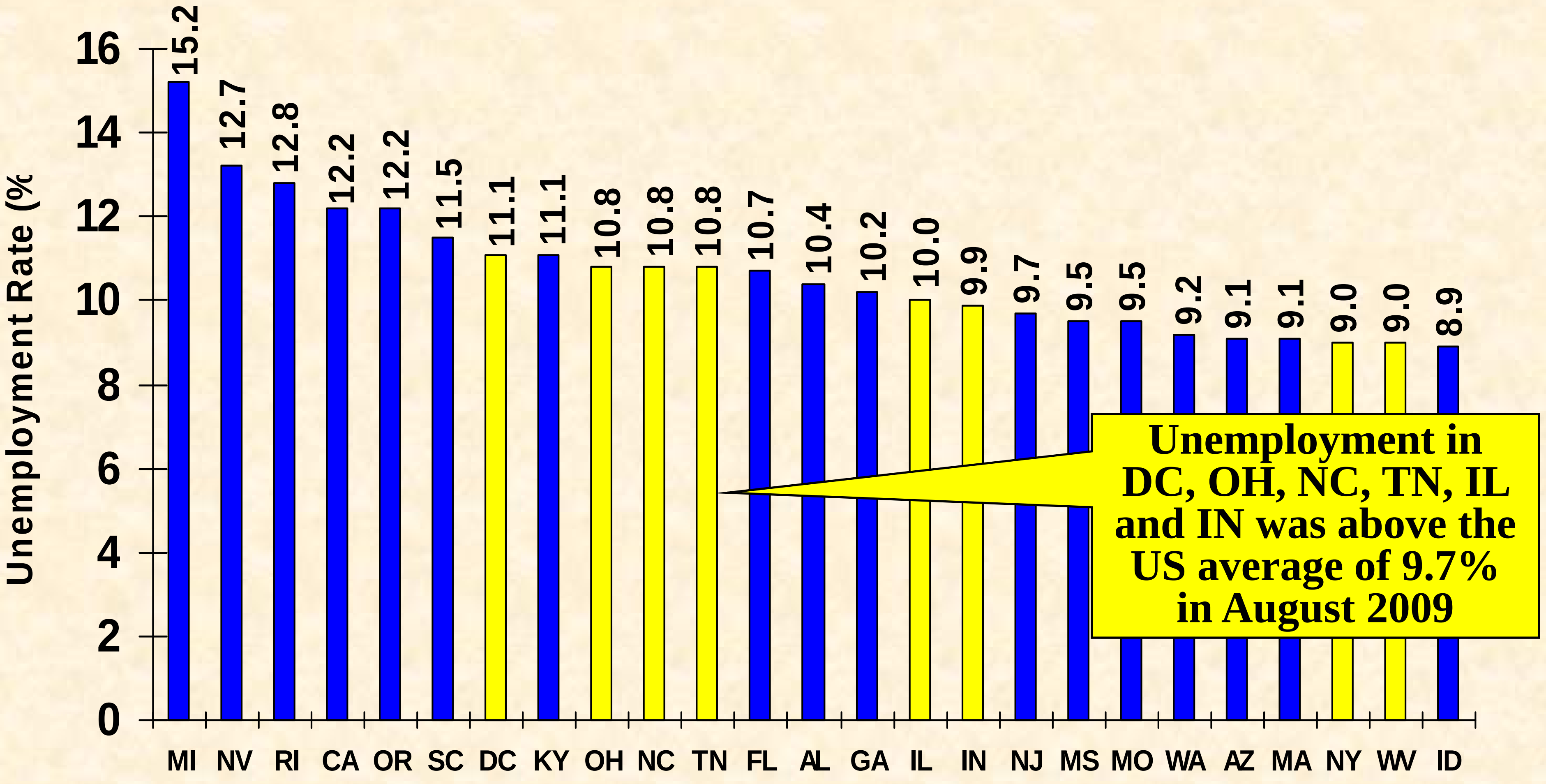
Wage & Salary Disbursements (Payroll Base) vs. Workers Comp Net Written Premiums



*Average Wage and Salary data as of 7/1/2009.

Source: US Bureau of Economic Analysis; Federal Reserve Bank of St. Louis at http://research.stlouisfed.org/fred2/series/WASCUR; I.I.I. Fact Books

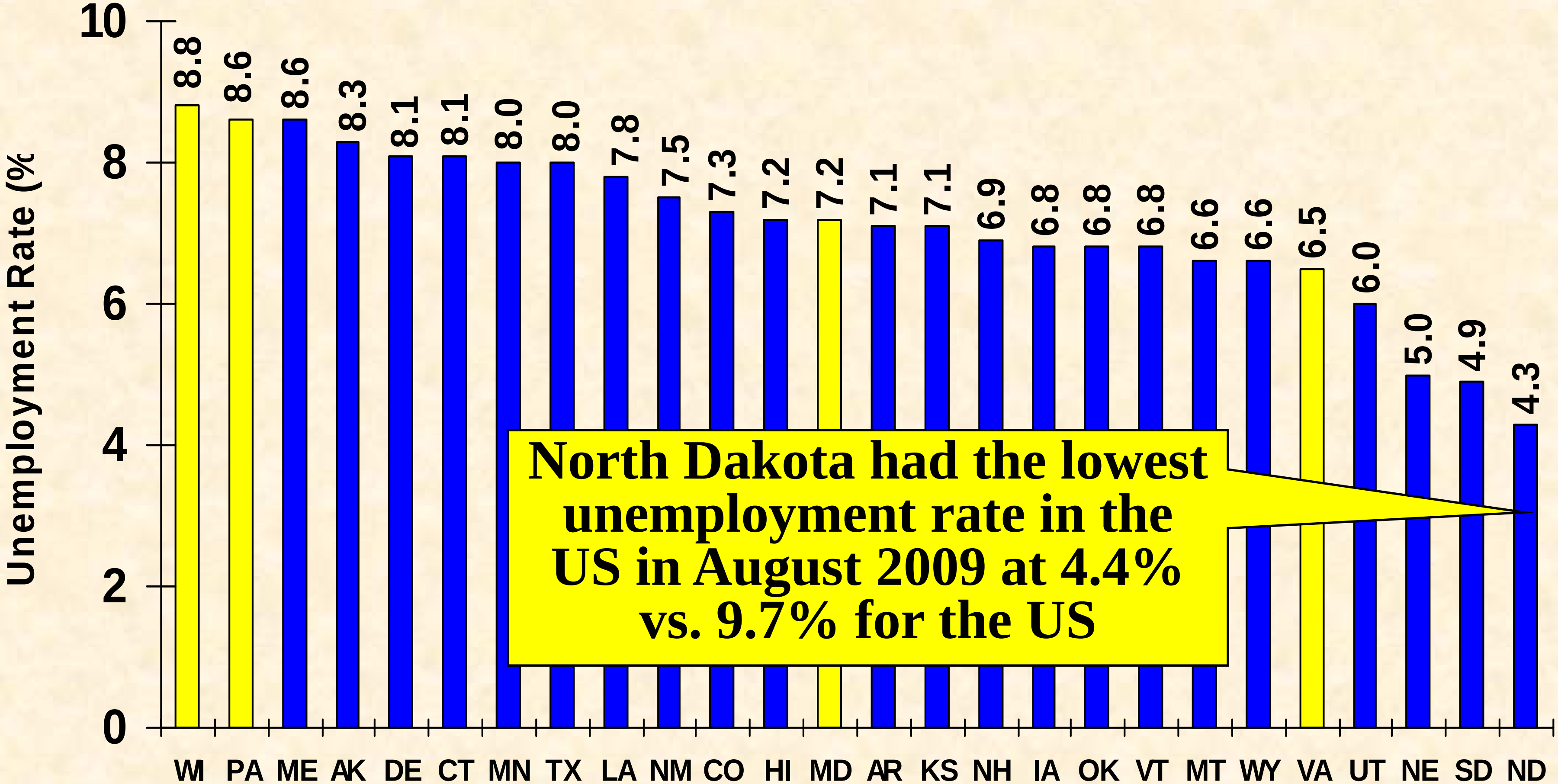
Unemployment Rates by State, August 2009: Highest 25 States*



*Provisional figures for August 2009, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute.

Unemployment Rates By State, August 2009: Lowest 25 States*



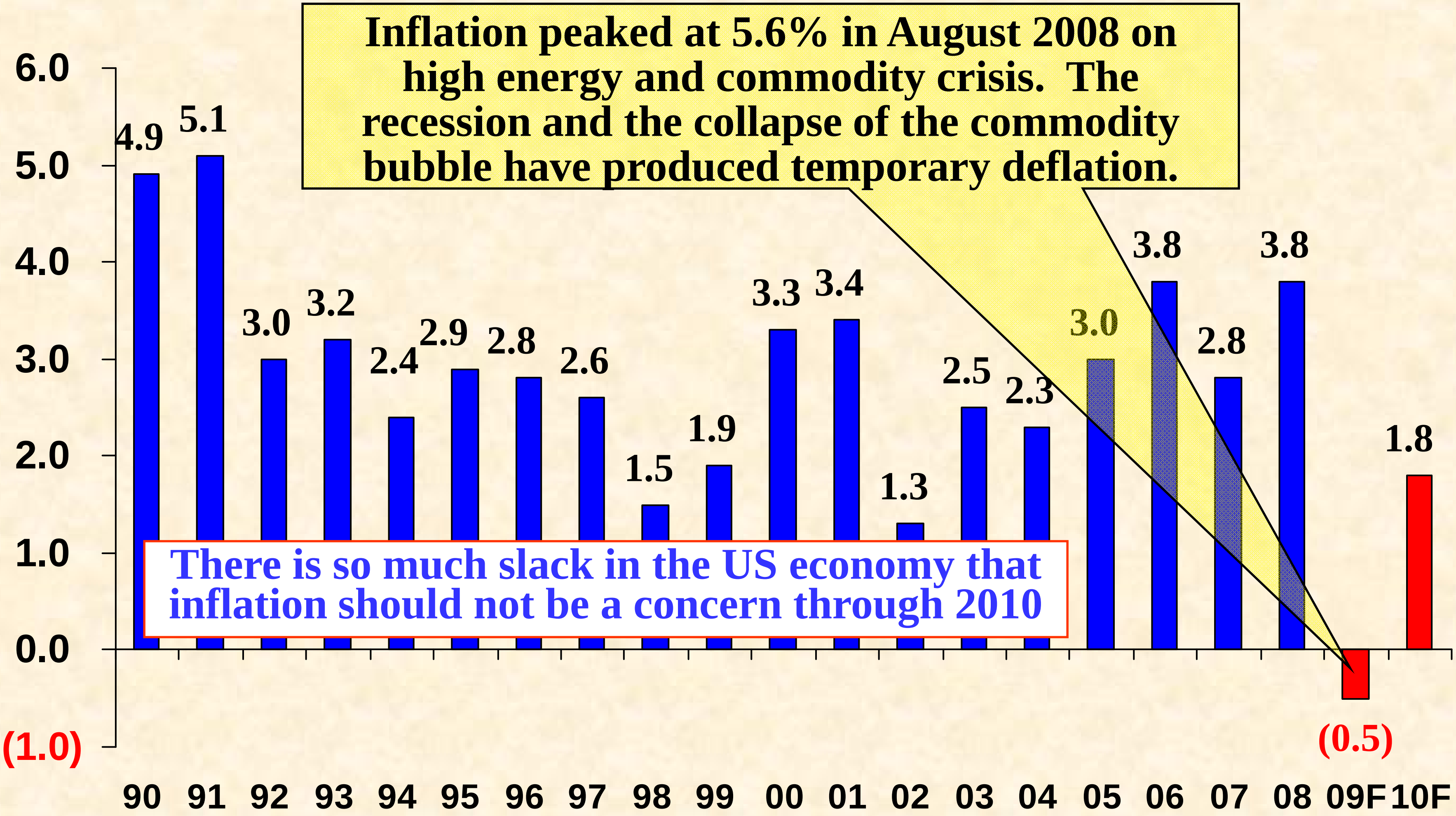
*Provisional figures for August 2009, seasonally adjusted.

Sources: US Bureau of Labor Statistics; Insurance Information Institute.

Inflation Trends

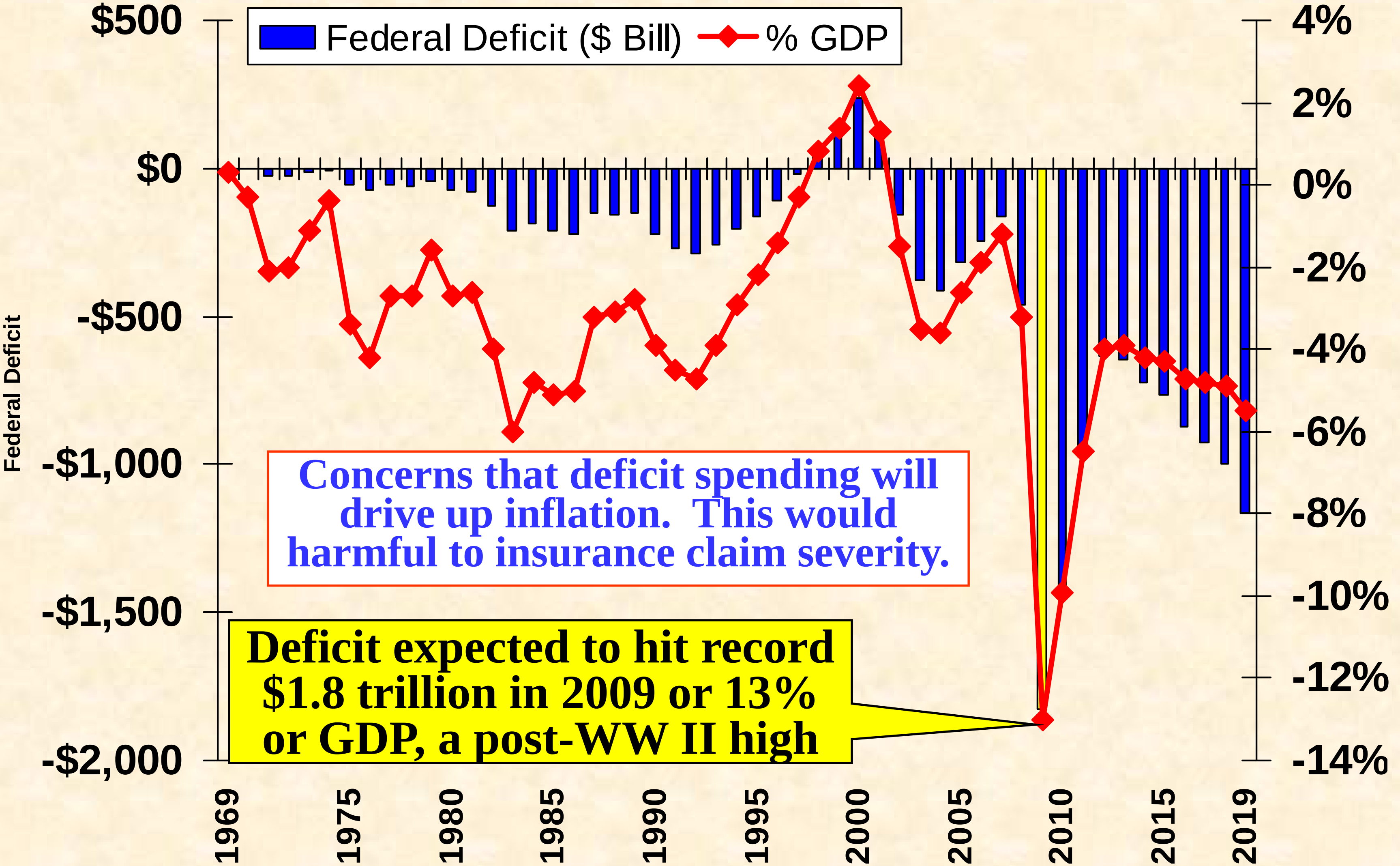
Pressures Claim Cost Severities via Medical and Tort Channels

Annual Inflation Rates (CPI-U, %), 1990-2010F



Sources: US Bureau of Labor Statistics; Blue Chip Economic Indicators, Sept. 10, 2009 (forecasts).

US Budget Deficit, 1969-2019F



Sources: Congressional Budget Office analysis of President's budget, March 2009; Insurance Information Institute.

Top Concerns/Risks for Insurers if Inflation is Reignited

CONCERNS: The Federal Reserve Has Flooded Financial System with Cash (Turned on the Printing Presses), the Federal Govt. Has Approved a $787B Stimulus and the Deficit is Expected to Mushroom to $1.8 Trillion. All Are Potentially Inflationary.

- **What are the potential impacts for insurers?**
- **What can/should insurers do to protect themselves from the risks of inflation?**

KEY RISKS FROM SUSTAINED/ACCELERATING INFLATION

- Rising Claim Severities
  - **Cost of claims settlement rises across the board (property and liability)**
- Rate Inadequacy
  - **Rates inadequate due to low trend assumptions arising from use of historical data**
- Reserve Inadequacy
  - **Reserves may develop adversely and become inadequate (deficient)**
- Burn Through on Retentions
  - **Retentions, deductibles burned through more quickly**
- Reinsurance Penetration/Exhaustion
  - **Higher costs→risks burn through their retentions more quickly, tapping into re-insurance more quickly and potential exhausting their reinsurance more quickly**

Source: Ins. Info. Inst.

State-by-State Infrastructure Spending & Job Gains

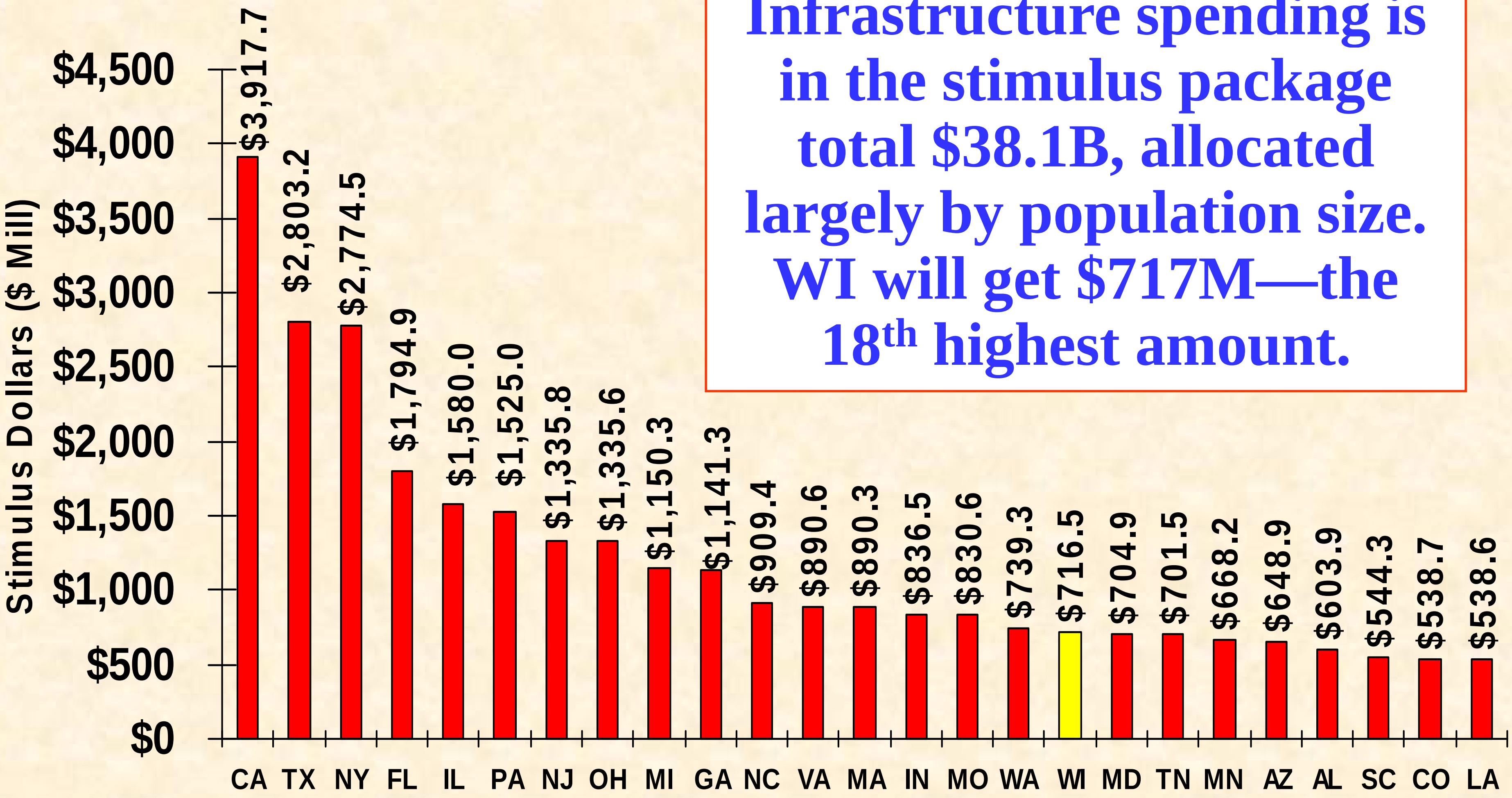
Bigger States Get More, Should Benefit Commercial Insurers Exposure

Infrastructure Stimulus Spending by State (Total = $38.1B)

State	Allocation	State	Allocation	State	Allocation
AL	$603,871,807	LA	$538,575,876	OK	$535,407,908
AK	$240,495,117	ME	$174,285,111	OR	$453,788,475
AZ	$648,928,995	MD	$704,863,248	PA	$1,525,011,979
AR	$405,531,459	MA	$890,333,825	RI	$192,902,023
CA	$3,917,656,769	MI	$1,150,282,308	SC	$544,291,398
CO	$538,669,174	MN	$668,242,481	SD	$213,511,174
CT	$487,480,166	MS	$415,257,720	TN	$701,516,776
DE	$158,666,838	MO	$830,647,063	TX	$2,803,249,599
DC	$267,617,455	MT	$246,599,815	UT	$292,231,904
FL	$1,794,913,566	NE	$278,897,762	VT	$150,666,577
GA	$1,141,255,941	NV	$270,010,945	VA	$890,584,959
HI	$199,866,172	NH	$181,678,856	WA	$739,283,923
ID	$219,528,313	NJ	$1,335,785,100	WV	$290,479,108
IL	$1,579,965,373	NM	$299,589,086	WI	$716,457,120
IN	$836,483,568	NY	$2,774,508,711	WY	$186,111,170
IA	$447,563,924	NC	$909,397,136	U.S. Territories	$238,045,760
KS	$413,837,382	ND	$200,318,301		
KY	$521,153,404	OH	$1,335,600,553	**Total**	**$38,101,898,173**

Sources: USA Today, 2/17/09; House Transportation and Infrastructure Committee; the Associated Press.

Infrastructure Stimulus Spending By State: Top 25 States ($ Millions)

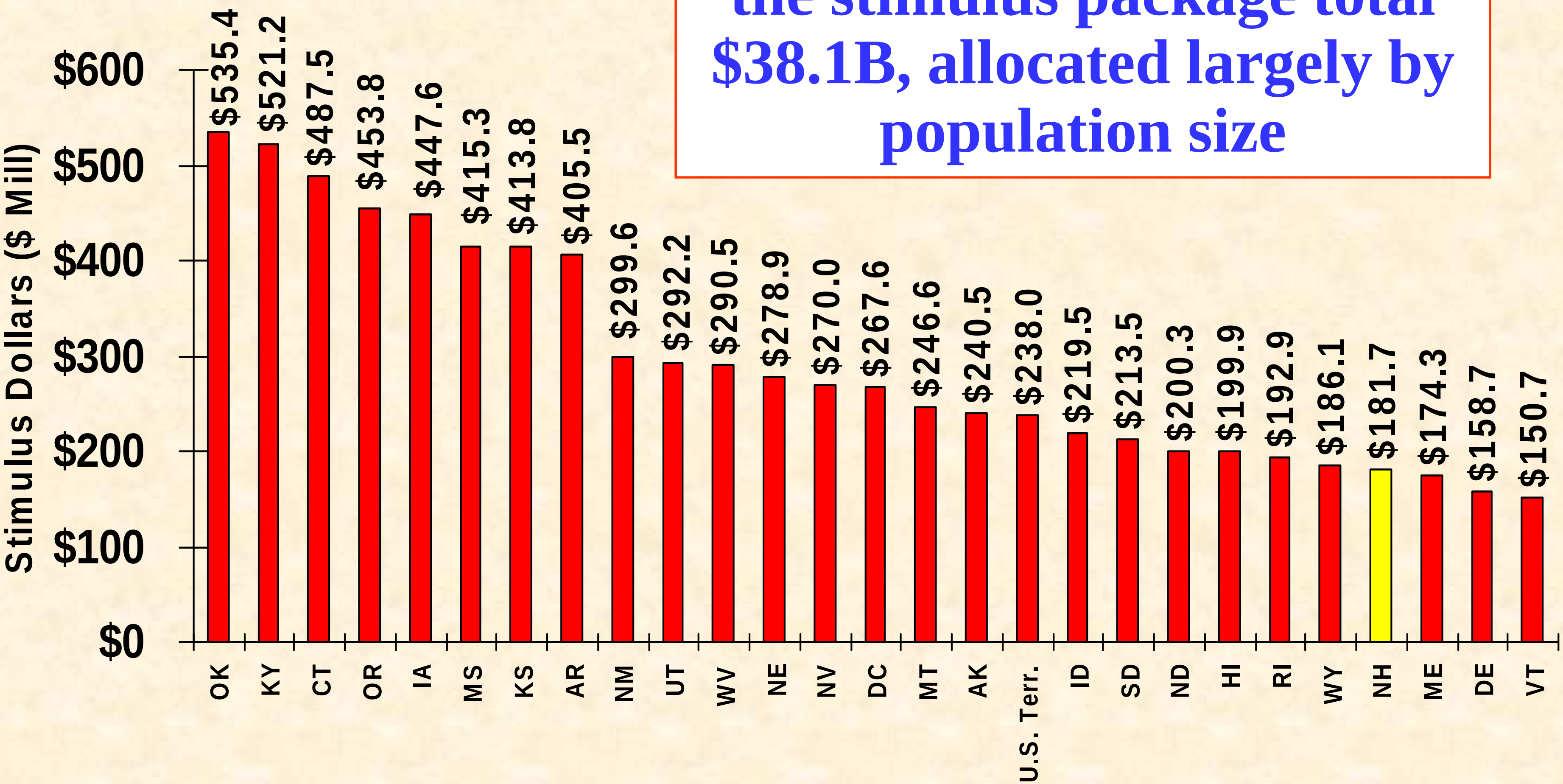


Infrastructure spending is in the stimulus package total $38.1B, allocated largely by population size. WI will get $717M—the 18th highest amount.

Sources: USA Today 2/19/09; House Transportation and Infrastructure Committee; the Associated Press.

Infrastructure Stimulus Spending By State: Bottom 25 States ($ Millions)

Infrastructure spending is in the stimulus package total $38.1B, allocated largely by population size



Sources: USA Today 2/19/09; House Transportation and Infrastructure Committee; the Associated Press.

Expected Number of Jobs Gained or Preserved by Stimulus Spending

Larger States = More Jobs Workers Comp Benefits

Estimated Job Effect of Stimulus: Jobs Created/Saved By State = 3.5 Mill Total

State	Jobs Created	State	Jobs Created	State	Jobs Created
AL	52,000	LA	50,000	OK	40,000
AK	8,000	ME	15,000	OR	44,000
AZ	70,000	MD	66,000	PA	143,000
AR	32,000	MA	79,000	RI	12,000
CA	396,000	MI	109,000	SC	50,000
CO	60,000	MN	66,000	SD	10,000
CT	41,000	MS	30,000	TN	71,000
DE	11,000	MO	69,000	TX	269,000
DC	12,000	MT	11,000	UT	32,000
FL	207,000	NE	23,000	VT	8,000
GA	107,000	NV	34,000	VA	93,000
HI	16,000	NH	16,000	WA	75,000
ID	17,000	NJ	100,000	WV	20,000
IL	148,000	NM	22,000	WI	70,000
IN	75,000	NY	215,000	WY	8,000
IA	37,000	NC	105,000		
KS	33,000	ND	9,000		
KY	48,000	OH	133,000	**Total**	**3,467,000**

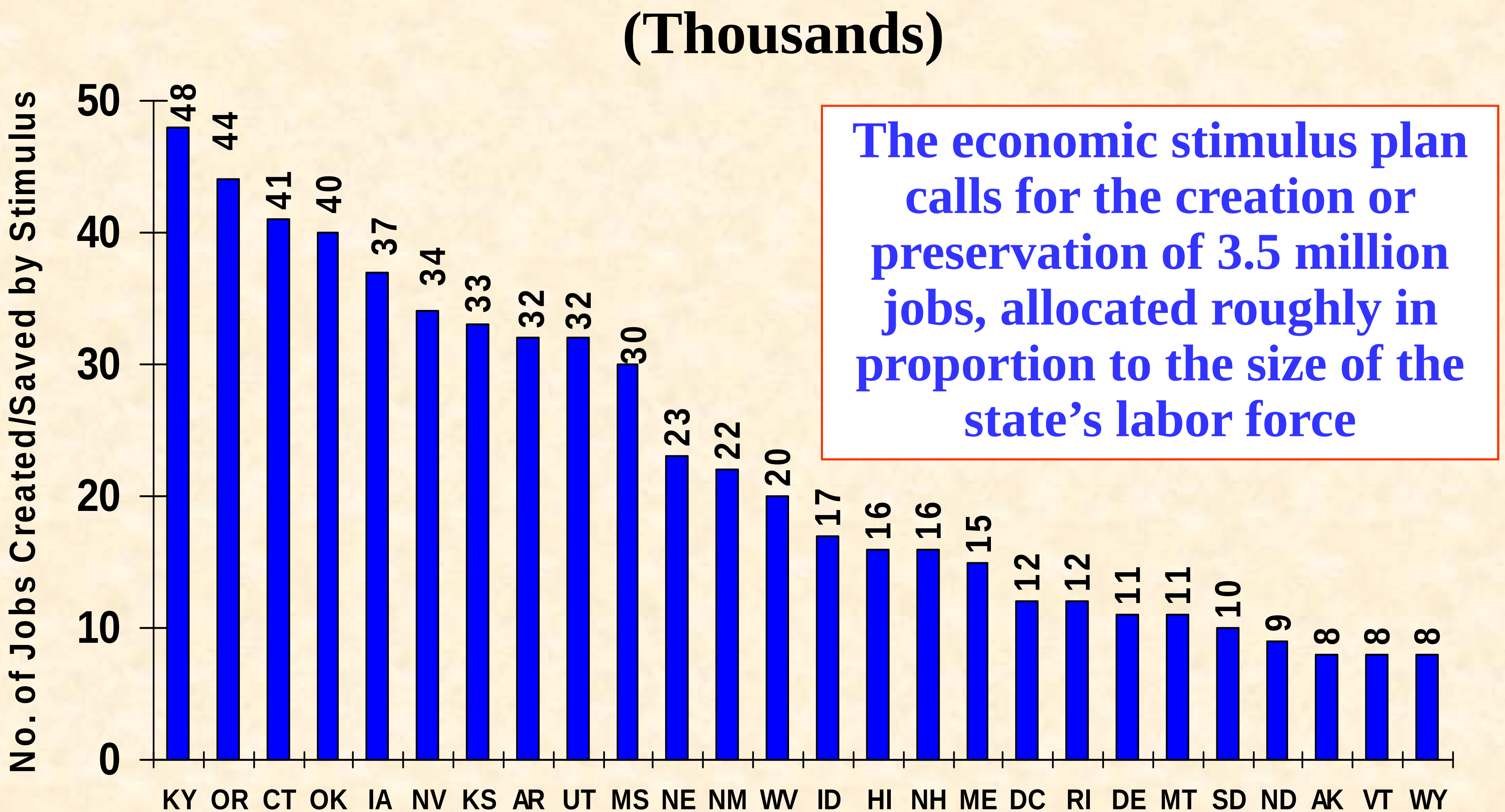
Sources: http://www.recovery.gov/; Council of Economic Advisers; Insurance Information Institute.

Estimated Job Effect of Stimulus Spending By State: Top 25 States

The economic stimulus plan calls for the creation or preservation of 3.5 million jobs, allocated roughly in proportion to the size of the state's labor force.

Sources: http://www.recovery.gov/; Council of Economic Advisers Insurance Information Institute.

Estimated Job Effect of Stimulus Spending By State: Bottom 25 States



Sources: http://www.recovery.gov/; Council of Economic Advisers Insurance Information Institute.

GREEN SHOOTS

Is the Recession Nearing an End?

Hopeful Signs That the Economy Will Begin to Recover Soon

- Recession Appears to be Bottoming Out, Freefall Has Ended
  - Pace of GDP shrinkage is beginning to diminish
  - Pace of job losses is slowing
  - Major stock market indices well off record lows, anticipating recovery
  - Some signs of retail sales stabilization are evident
- Financial Sector is Stabilizing
  - Banks are reporting quarterly profits
  - Many banks expanding lending to credit worthy people & businesses
- Housing Sector Likely to Find Bottom Soon
  - Home are much more affordable (attracting buyers)
  - Mortgage rates are still low relative to pre-crisis levels (attracting buyers)
  - Freefall in housing starts and existing home sales is ending in many areas
- Inflation & Energy Prices Are Under Control
- Consumer & Business Debt Loads Are Shrinking

Source: Ins. Info. Inst.

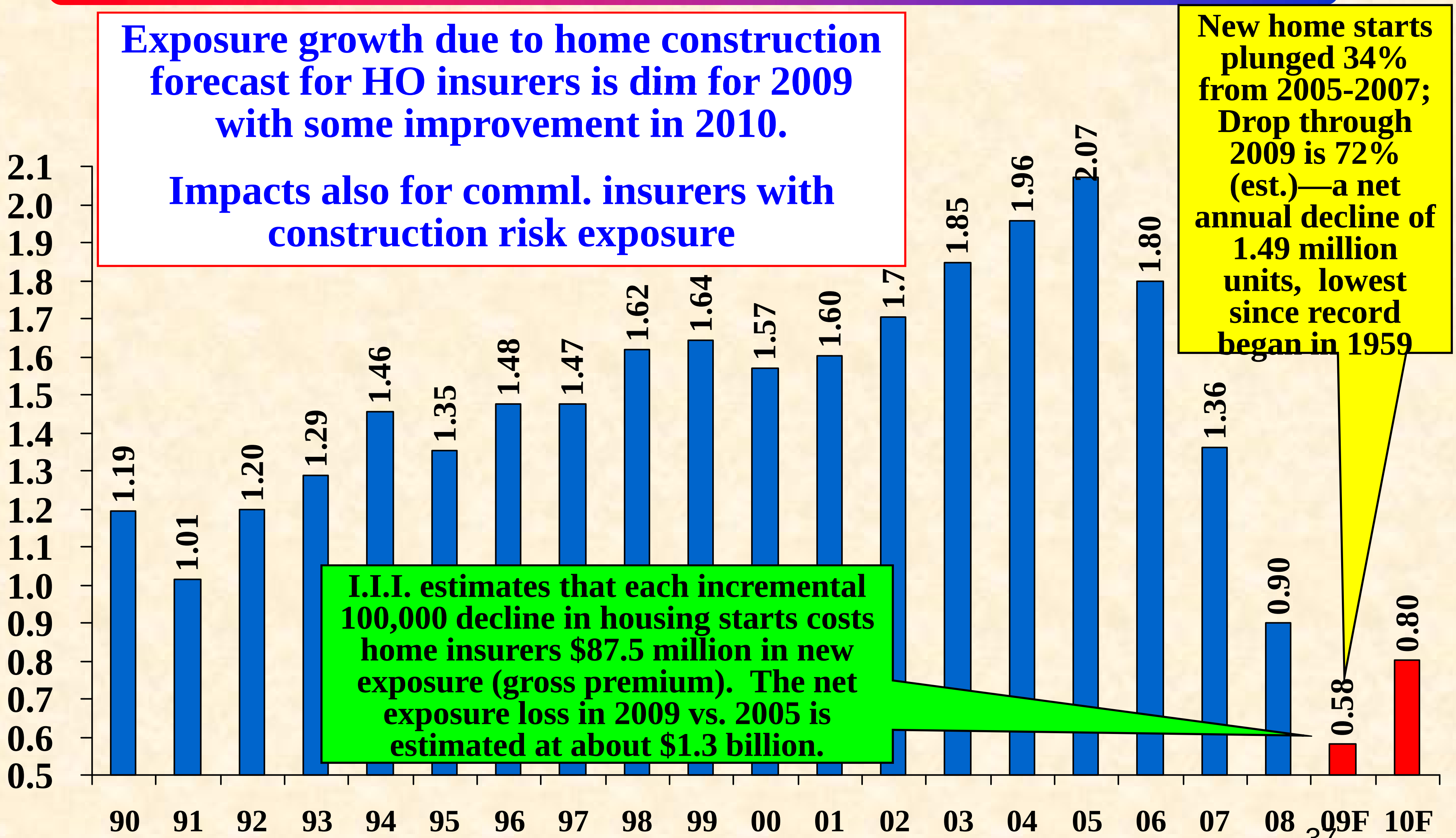
11 Industries for the Next 10 Years: Insurance Solutions Needed

Government
Education
Health Care
Energy (Traditional)
Alternative Energy
Agriculture
Natural Resources
Environmental
Technology
Light Manufacturing
Export Oriented Industries

Crisis-Driven Exposure Implications

Home, Auto, Exposure Growth Slows as Sales Nosedive

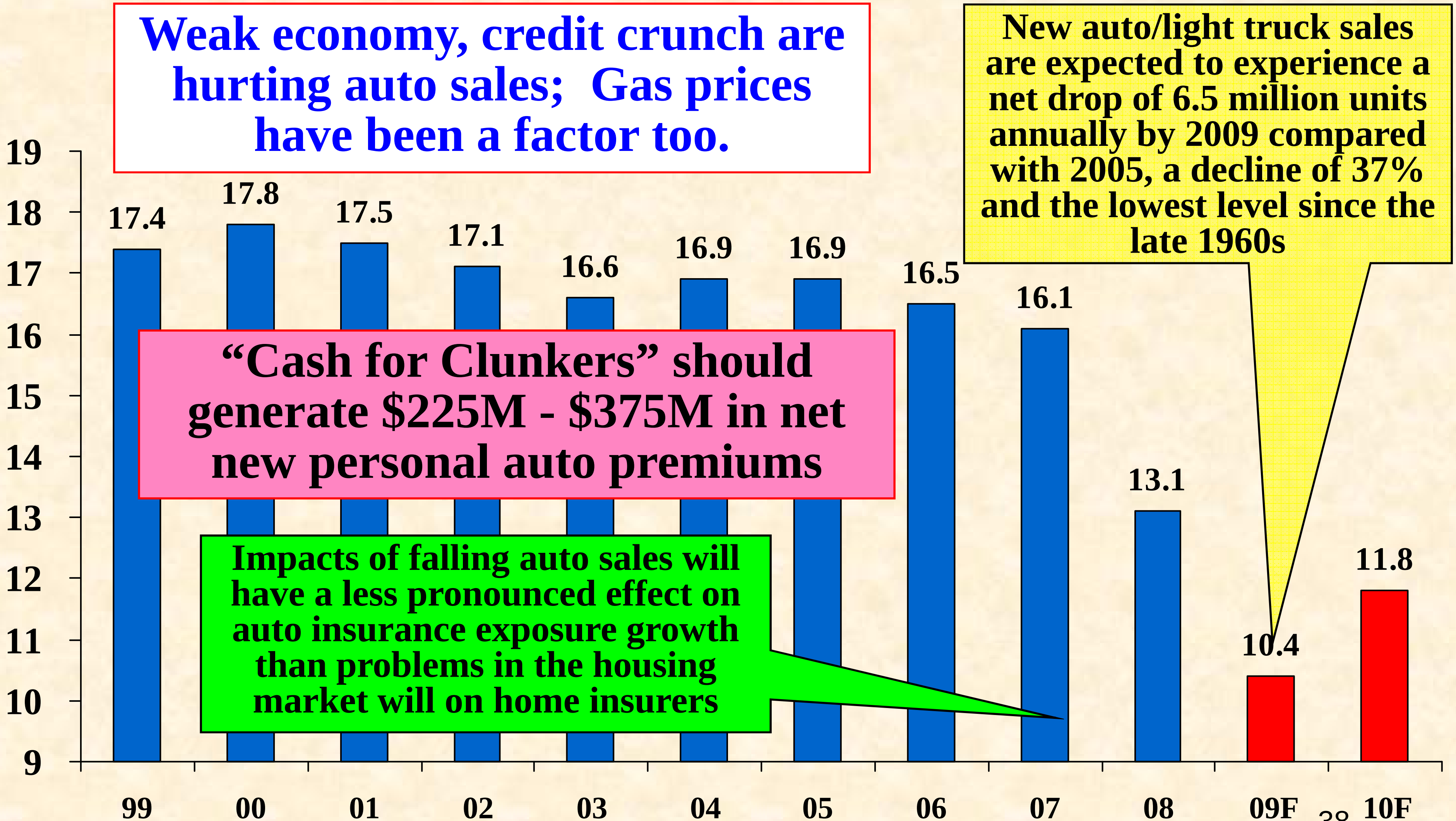
New Private Housing Starts, 1990-2010F (Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (9/09); Insurance Information Inst.

Auto/Light Truck Sales, 1999-2010F *(Millions of Units)*

Weak economy, credit crunch are hurting auto sales; Gas prices have been a factor too.



Source: US Department of Commerce; Blue Chip Economic Indicators (9/09); Insurance Information Inst.

Key Threats Facing Insurers Amid Financial Crisis

Challenges for the Next 5-8 Years

Important Issues & Threats Facing Insurers: 2009 - 2015

1. Erosion of Capital

- **Losses are larger and occurring more rapidly than is commonly understood or presumed**
- **Max surplus loss at 3/31/09 was 16%=$85B from 9/30/07 peak**
- **P/C policyholder surplus could have been much larger**
- **Some insurers propped up results by reserve releases**
- **Decline in PHS of 1999-2002 was 15% over 3 years and was entirely made up and them some in 2003. Current decline was ~16% in 5 qtrs.**
- **During the opening years of the Great Depression (1929-1933) PHS fell 37%, Assets fell 28% and Net Written Premiums fell by 35%. It took until 1939-40 before these key measures returned to their 1929 peaks.**
- **BOTTOM LINE: Capital and assets could have fallen farther and faster than many believed possible. It will take years to return to the 2007 peaks—likely late 2011/12 (without market relapse).**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

2. Reloading Capital After "Capital Event"

- **Continued asset price erosion coupled with major "capital event" would have lead to shortage of capital among *some* companies**
- **Possible Consequences: Insolvencies, forced mergers, calls for govt. aid, requests to relax capital requirements**
- **P/C insurers have come to assume that large amounts of capital can be raised quickly and cheaply after major events (post-9/11, Katrina).**
  - ***This assumption may be incorrect in the current environment***
- **Cost of capital is *much* higher today (relative "risk-free" rates), reflecting both scarcity & risk**
- **Implications: P/C (re)insurers need to protect capital today and develop detailed contingency plans to raise fresh capital & generate internally. Already a reality for some life insurers.**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

3. Long-Term Reduction in Investment Earnings

- **Low interest rates, risk aversion toward equities and many categories of fixed income securities lock in a multi-year trajectory toward ever lower investment gains**
- **Fed actions in Treasury markets keep yields low**
- **Many insurers have not adjusted to this new investment paradigm of a sustained period of low investment gains**
- ***Regulators will not readily accept it*; Many will reject it**
- **Implication 1: Industry must be prepared to operate in environment with investment earnings accounting for a smaller fraction of profits**
- **Implication 2: Implies underwriting discipline of a magnitude not witnessed in this industry in more than 30 years. Yet to manifest itself.**
- **Lessons from the period 1920-1975 need to be relearned**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 – 2???

4. Regulatory Overreach

- **Principle danger is that P/C insurers get swept into vast federal regulatory overhaul and subjected to inappropriate, duplicative and costly regulation (Dual Regulation)**
- **Danger is high as feds get their nose under the tent**
- **Status Quo is viewed as unacceptable by all**
- **Pushing for major change is not without *significant* risk in the current highly charged political environment**
- **Insurance & systemic risk**
- **Disunity within the insurance industry**
- **Impact of regulatory changes will be felt for decades**
- **Bottom Line: Regulatory outcome is uncertain and risk of adverse outcome exists**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

5. Creeping Restrictions on Underwriting

- **Attacks on underwriting criteria such as credit, education, occupation, territory increasing**
- **Industry will lose some battles**
- **View that use of numerous criteria are discriminatory and create an adverse impact on certain populations**
- **Impact will be to degrade the accuracy of rating systems to increase subsidies**
- **Predictive modeling also at risk**
- **Current social and economic environment could accelerate these efforts**
- **Danger that bans could be codified at federal level during regulatory overhaul**
- **Bottom Line: Industry must be prepared to defend existing and new criteria indefinitely**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 - 2015

6. **Exploitation of Insurance as a Wealth Redistribution Mechanism**
   - **There is a longstanding history of attempts to use insurance to advance wealth redistribution/economic agendas**
   - **Urban subsidies; Coastal subsidies are old; Could be extended to workers comp in variety of ways**
   - **Insurer focus on underwriting profitability (resulting in higher rates) coupled with poor economic conditions could raise profile of affordability issue**
   - **Calls for "excess profits tax" on insurers**
   - **Increased government involvement in insurance (including ownership stakes) make this more likely**
   - **Federal regulation could impose such redistribution schemes**
   - **Bottom Line: Expect efforts to address social and economic inequities through insurance**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 -2015

7. Creeping Socialization and Partial Nationalization of Insurance System

- **CAT risk is, on net, being socialized directly via state-run insurance and reinsurance mechanisms or via elaborate subsidy schemes involving assessments, premium tax credits, etc.**
- **Some (life) insurers sought/received TARP money**
- **Efforts to expand flood program to include wind**
- **Health insurance may be substantively socialized**
- **Terrorism risk—already a major federal role backed by insurers**
- **Eventually impacts for other lines such as personal auto, *WC*?**
- **Feds, states may open to more socialization of private insurance risk**
- **Ownership stakes in some insurers could be a slippery slope**
- **States like FL will lean heavily on Washington in the event of a mega-cat that threatens state finance**
- **Bottom Line: Additional socialization likely. Can insurers/will insurers draw the line?**

Source: Insurance Information Inst.

Important Issues & Threats Facing Insurers: 2009 -2015

8. Emerging Tort Threat

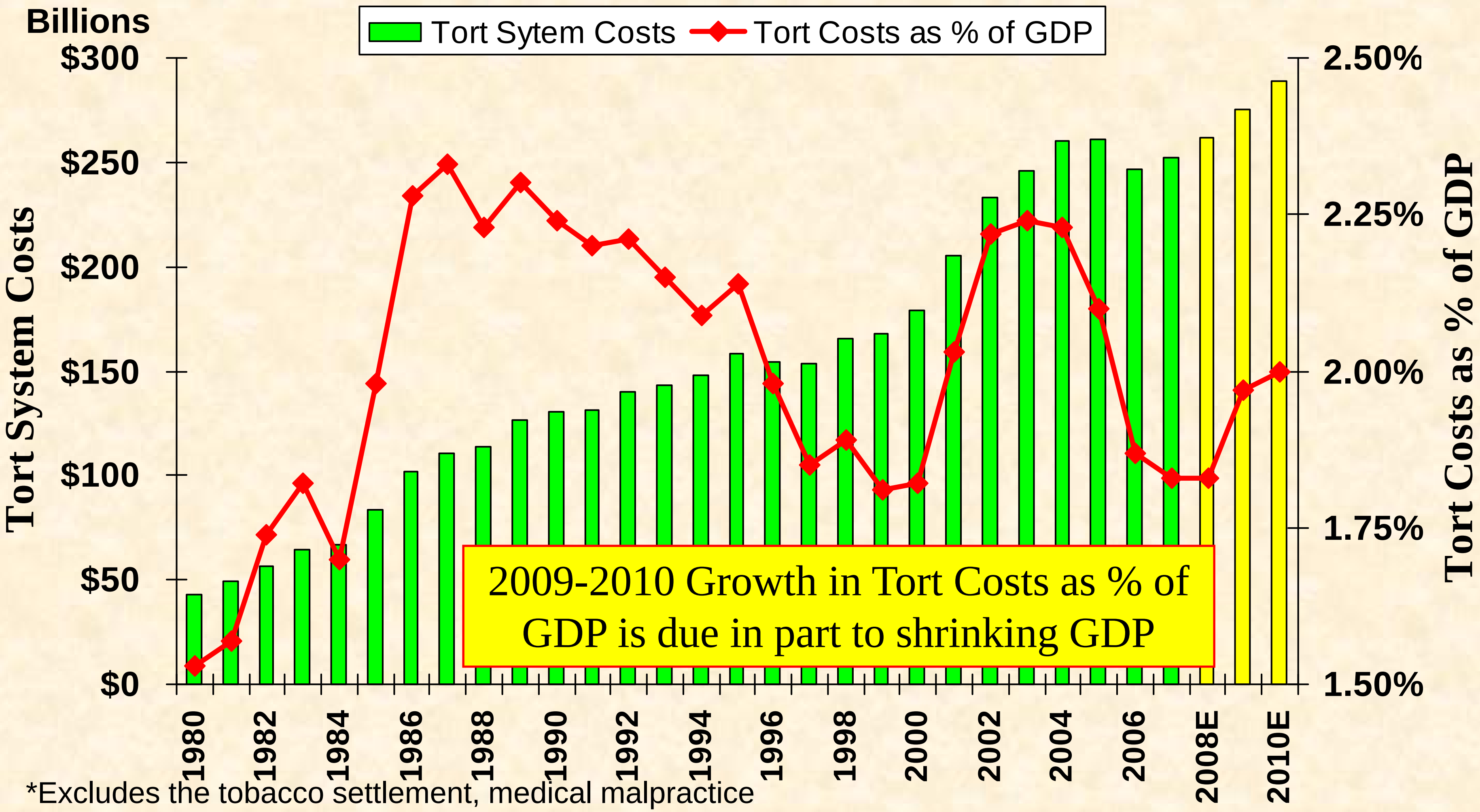
- **No tort reform (or protection of recent reforms) is forthcoming from the current Congress or Administration**
- **Erosion of recent reforms is a certainty (already happening)**
- **Innumerable legislative initiatives will create opportunities to undermine existing reforms and develop new theories and channels of liability**
- **Torts twice the overall rate of inflation**
- **Influence personal and commercial lines, esp. auto liab.**
- **Historically *extremely* costly to p/c insurance industry**
- **Leads to reserve deficiency, rate pressure**
- **Bottom Line: Tort "crisis" is on the horizon and will be recognized as such by 2012-2014**

Source: Insurance Information Inst.

Shifting Legal Liability & Tort Environment

Is the Tort Pendulum Swinging Against Insurers?

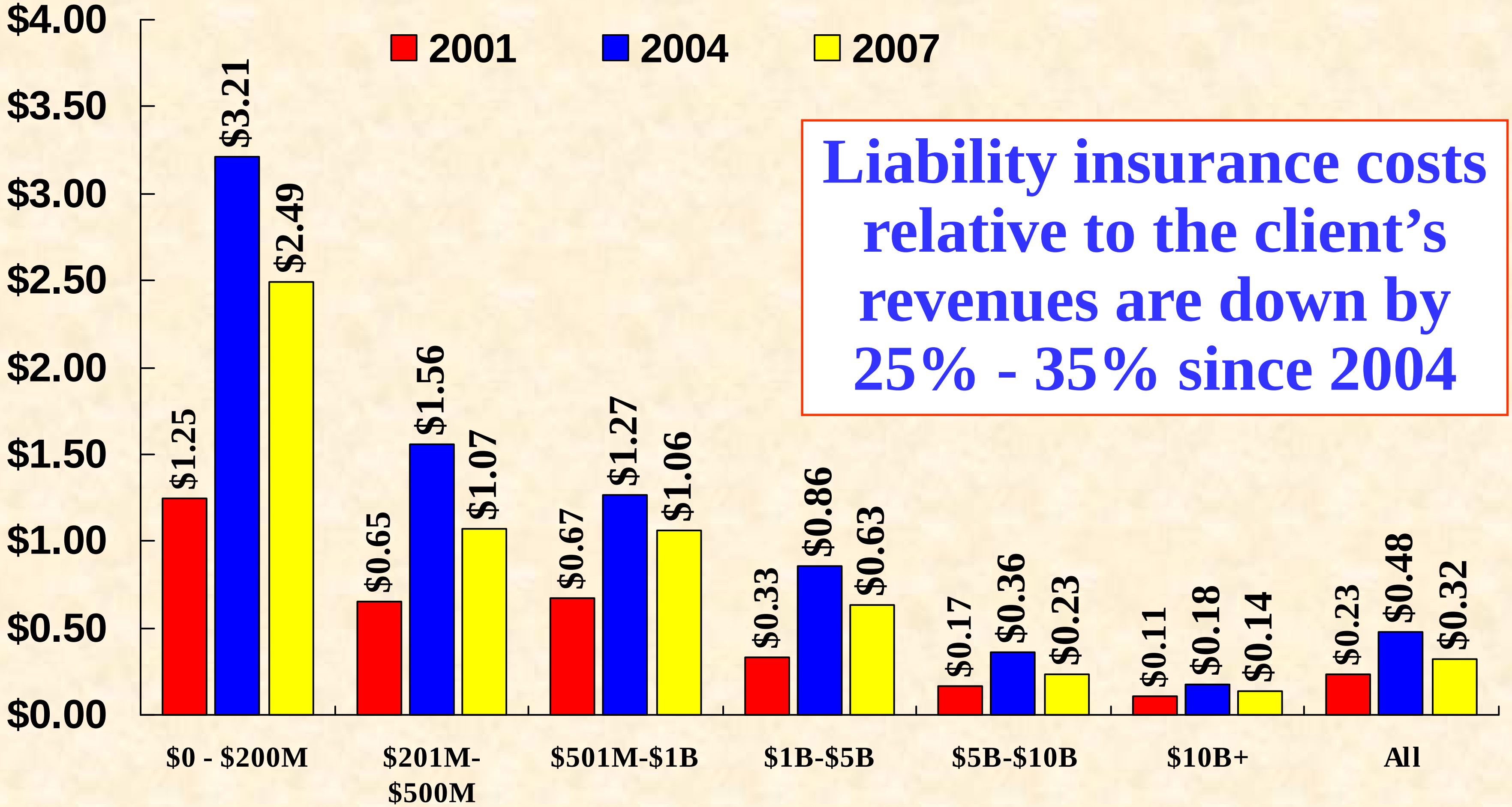
Over the Last Three Decades, Total Tort Costs* as a % of GDP Appear Somewhat Cyclical



*Excludes the tobacco settlement, medical malpractice

Sources: Tillinghast-Towers Perrin, *2008 Update on US Tort Cost Trends,* Appendix 1A; I.I.I. calculations/estimates for 2009 and 2010

Liability: Average Cost per $1,000 of Revenue United States, 2001 to 2007*



Liability insurance costs relative to the client's revenues are down by 25% - 35% since 2004

***Across entire liability program (full population)**

Source: Marsh, 2007 Limits of Liability Report

Business Leaders Ranking of Liability Systems for 2008

Best States

1. Delaware
2. Nebraska
3. Maine
4. Indiana
5. Utah
6. Virginia
7. Iowa
8. Vermont
9. Colorado
10. Kansas

New in 2008

CO, IN, KS, VA, VT

Drop-Offs

MN, NH, TN, WI

Midwest/West has mix of good and bad states

Worst States

41. Texas
42. Florida
43. South Carolina
44. California
45. Hawaii
46. Illinois
47. Alabama
48. Mississippi
49. Louisiana
50. West Virginia

Newly Notorious

FL, SC

Rising Above

AR, AK

Source: US Chamber of Commerce 2008 State Liability Systems Ranking Study; Insurance Info. Institute.

The Nation's Judicial Hellholes (2008/2009)

Watch List

Rio Grande Valley & Gulf Coast, TX

Madison County, IL

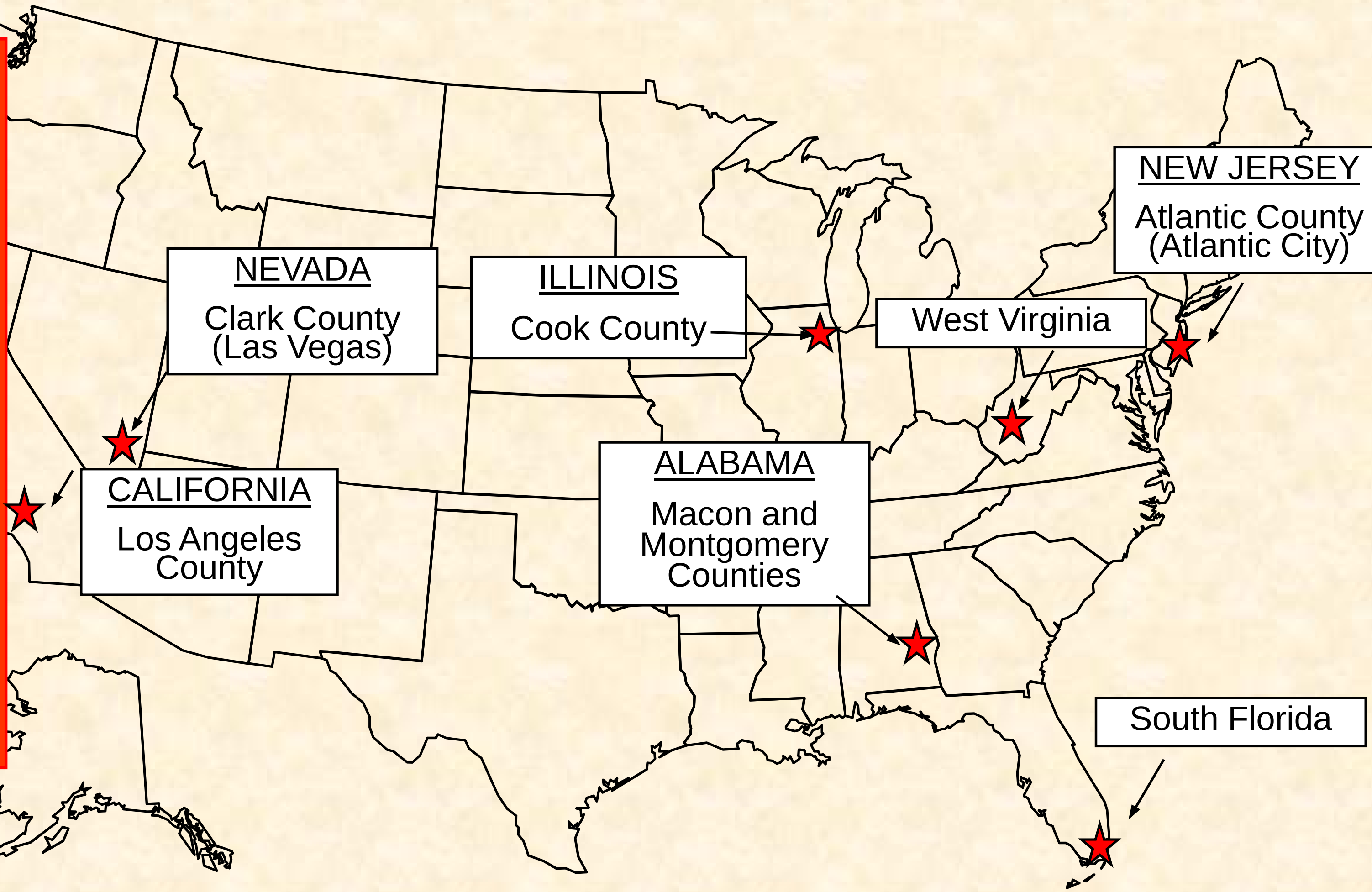
Baltimore, MD

St Louis (the city of), St Louis and Jackson Counties, MO

Dishonorable Mentions

MA Supreme Judicial Court

MO Supreme Court



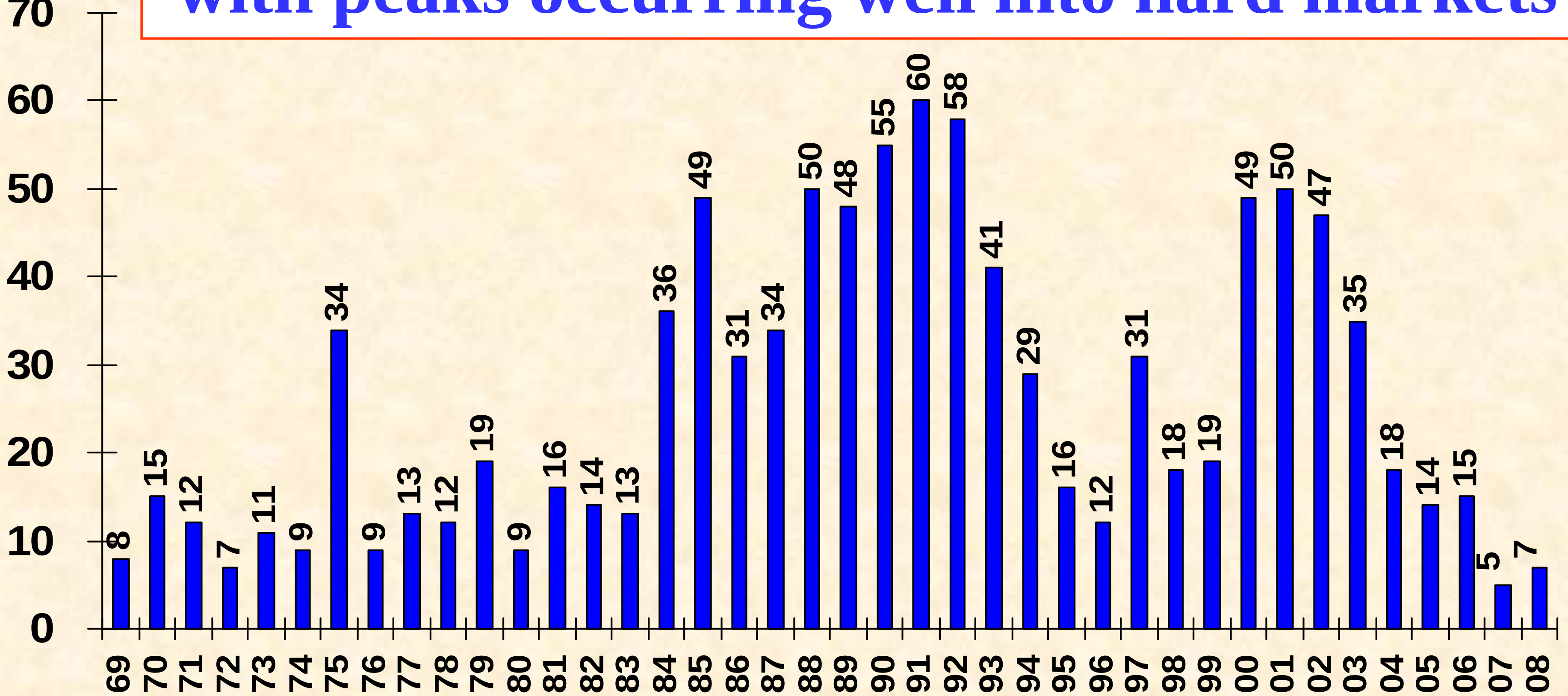
Source: American Tort Reform Association; Insurance Information Institute

FINANCIAL STRENGTH & RATINGS

Industry Has Weathered the Storms Well

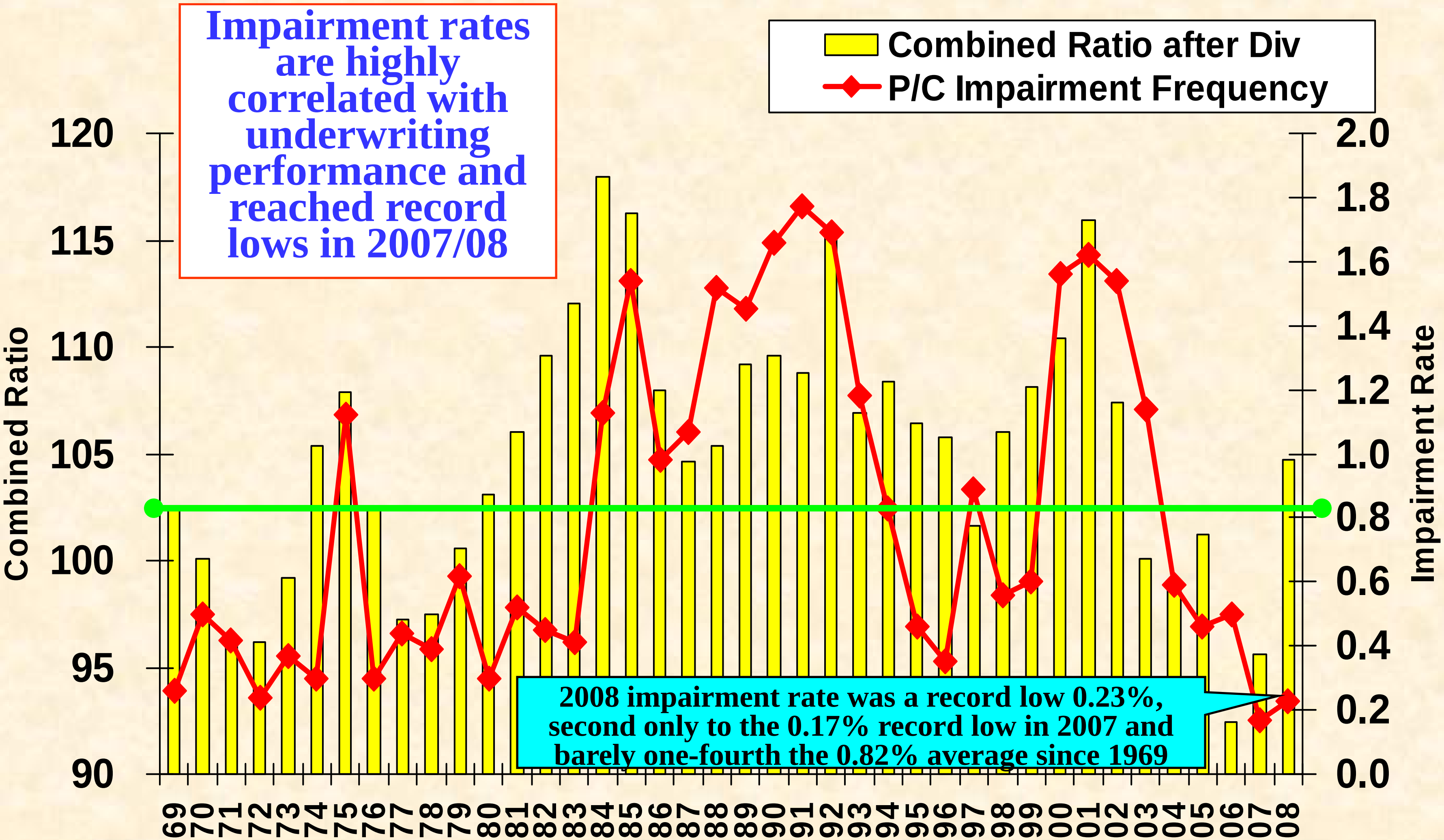
P/C Insurer Impairments, 1969-2008

The number of impairments varies significantly over the p/c insurance cycle, with peaks occurring well into hard markets



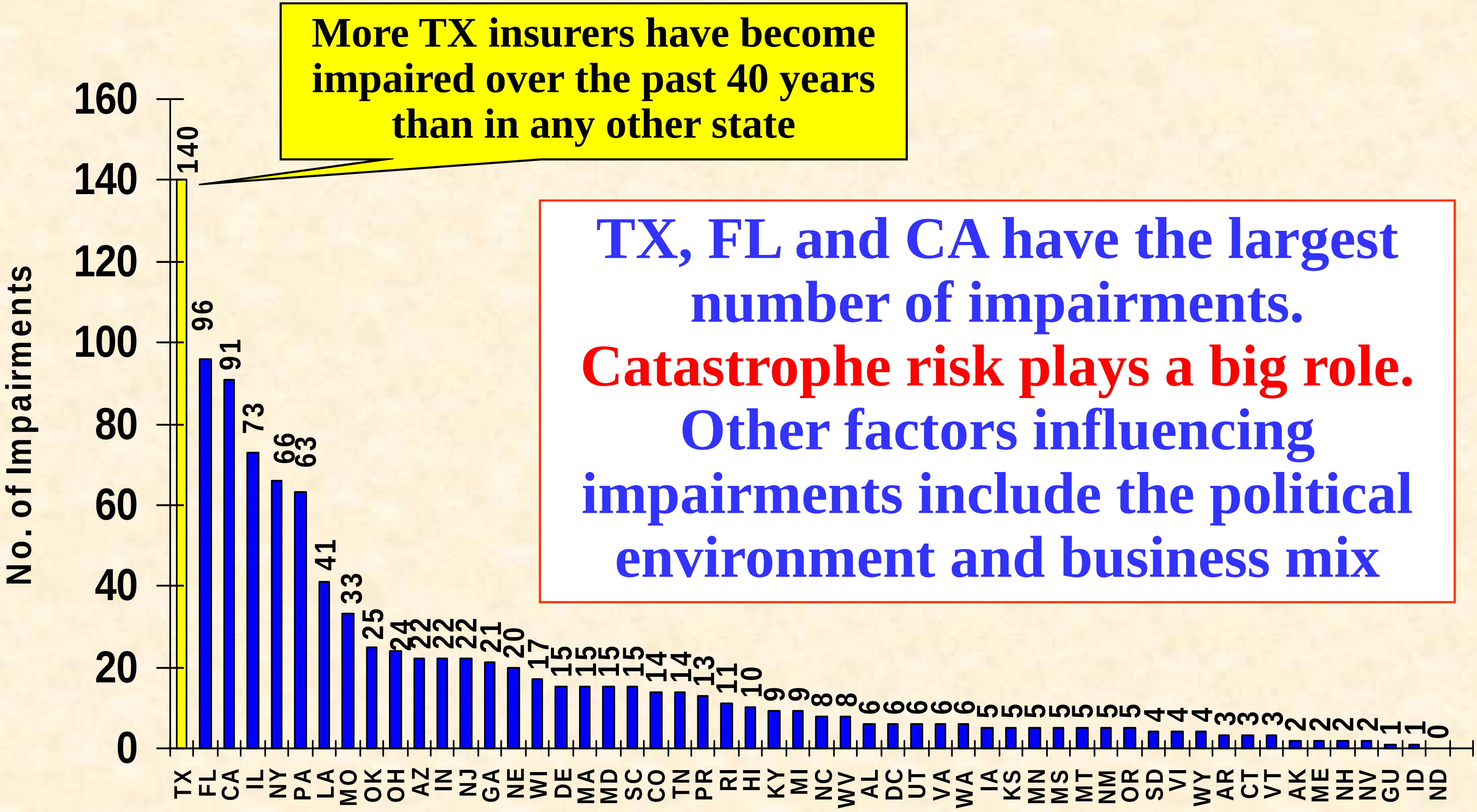
Source: A.M. Best; Insurance Information Institute

P/C Insurer Impairment Frequency vs. Combined Ratio, 1969-2008



Source: A.M. Best; Insurance Information Institute

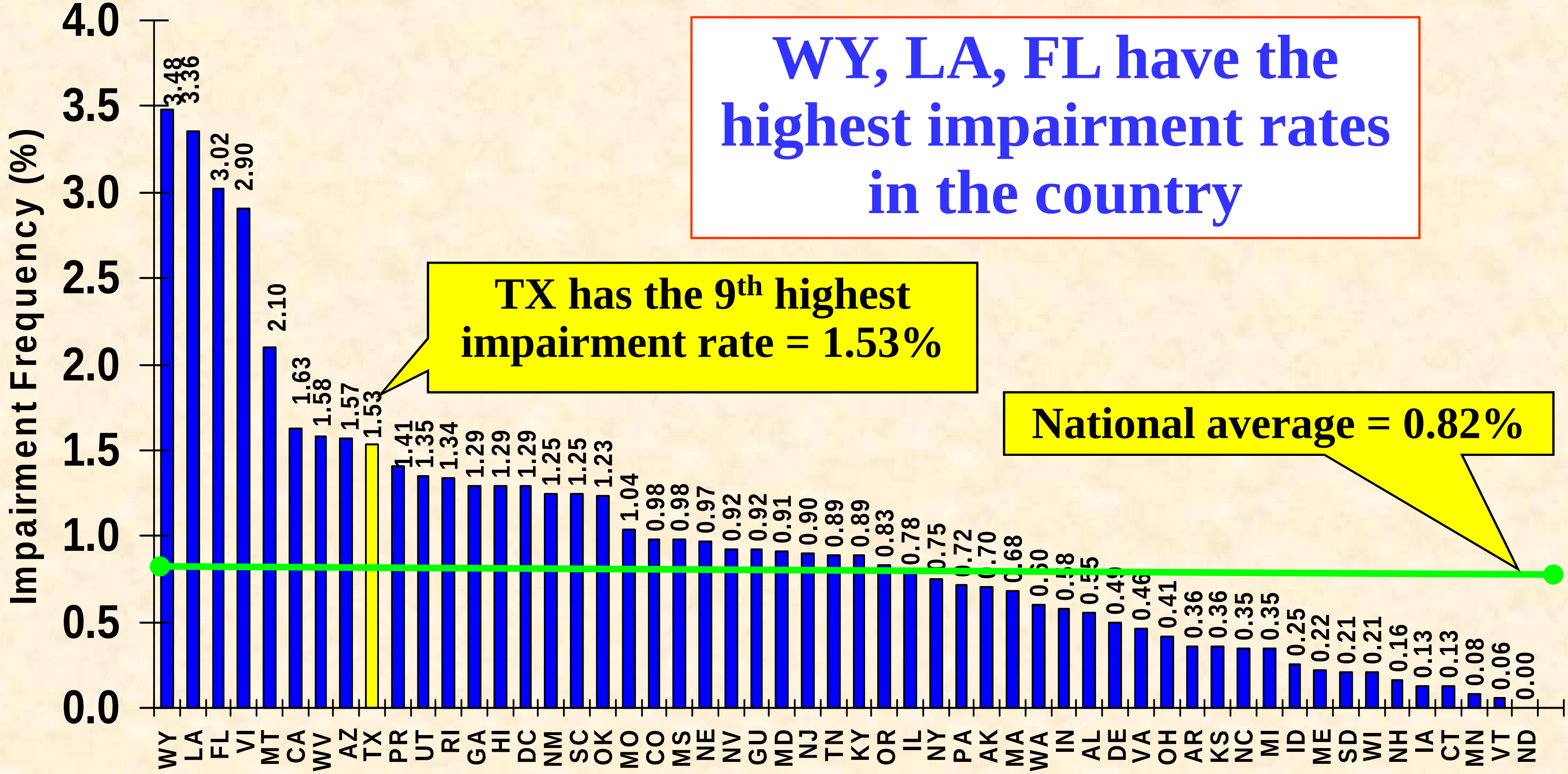
Number of Impairments by State, 1969-2008



Source: A.M. Best; Insurance Information Institute

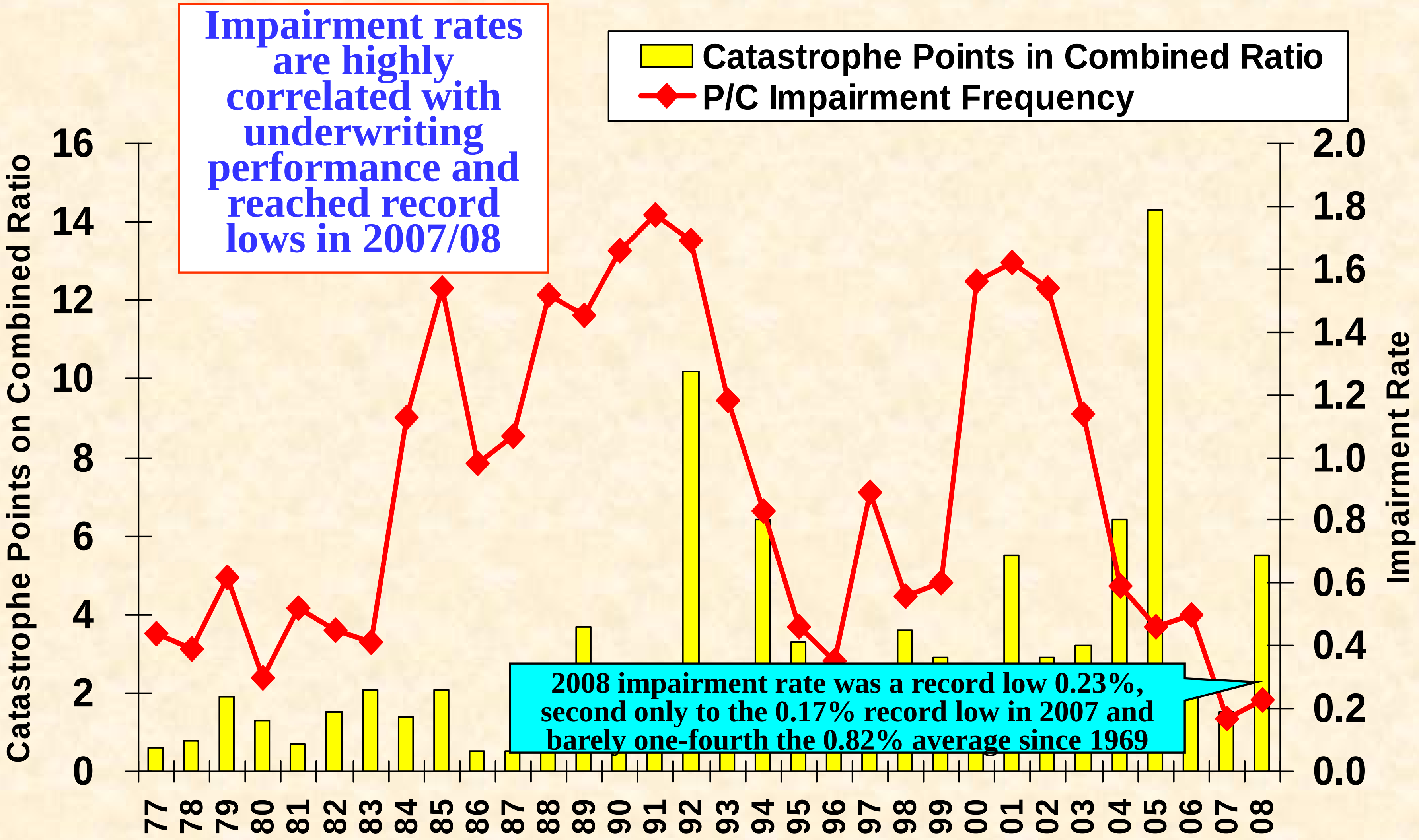
Frequency of Impairments by State, 1969-2008

(Impairments per 100 Insurers Domiciled in State)



Source: A.M. Best; Insurance Information Institute

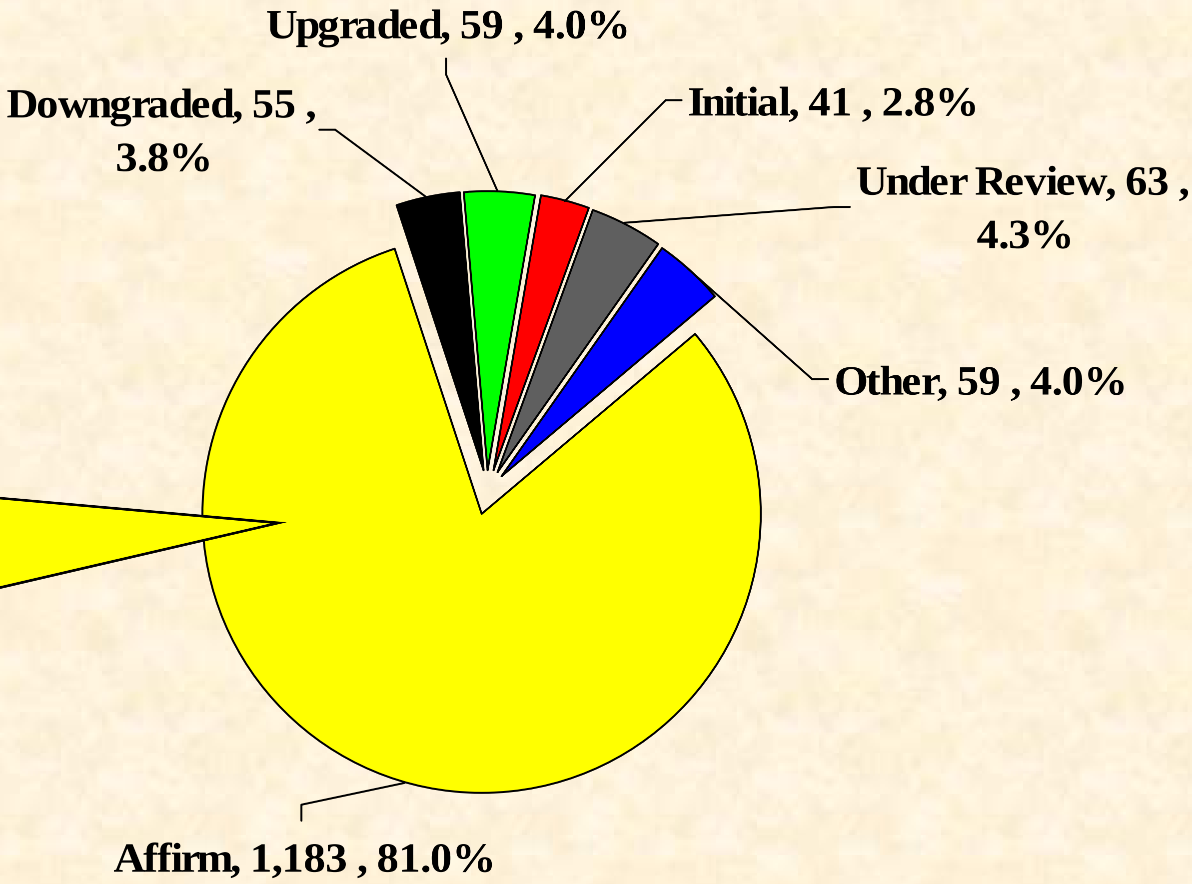
P/C Impairment Frequency vs. Catastrophe Points in Combined Ratio, 1977-2008



Source: A.M. Best, PCS; Insurance Information Institute

Summary of A.M. Best's P/C Insurer Ratings Actions in 2008*

P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.



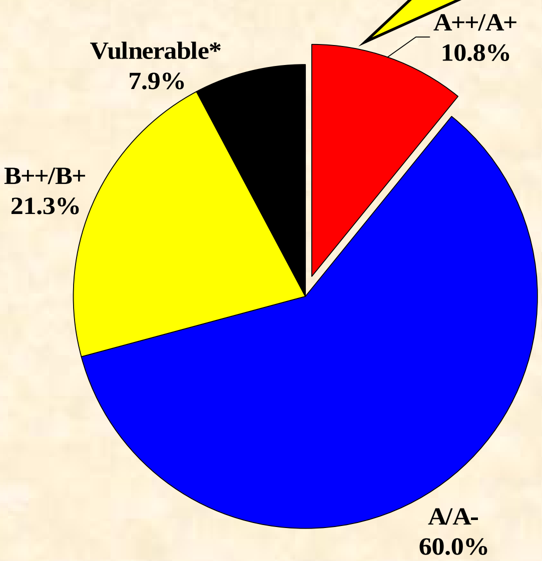
Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades

*Through December 19.
Source: A.M. Best.

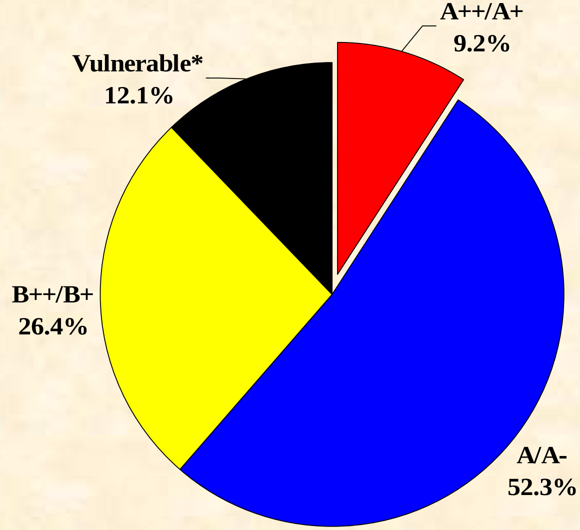
Historical Ratings Distribution, US P/C Insurers, 2008 vs. 2005 and 2000

2008

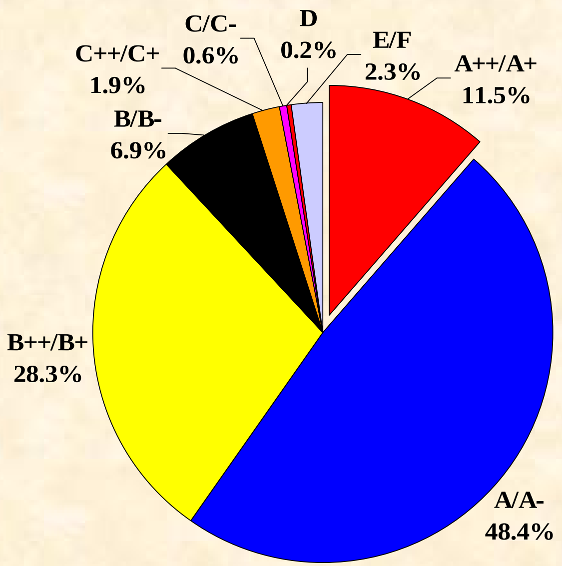
A++/A+ and A/A- gains



2005



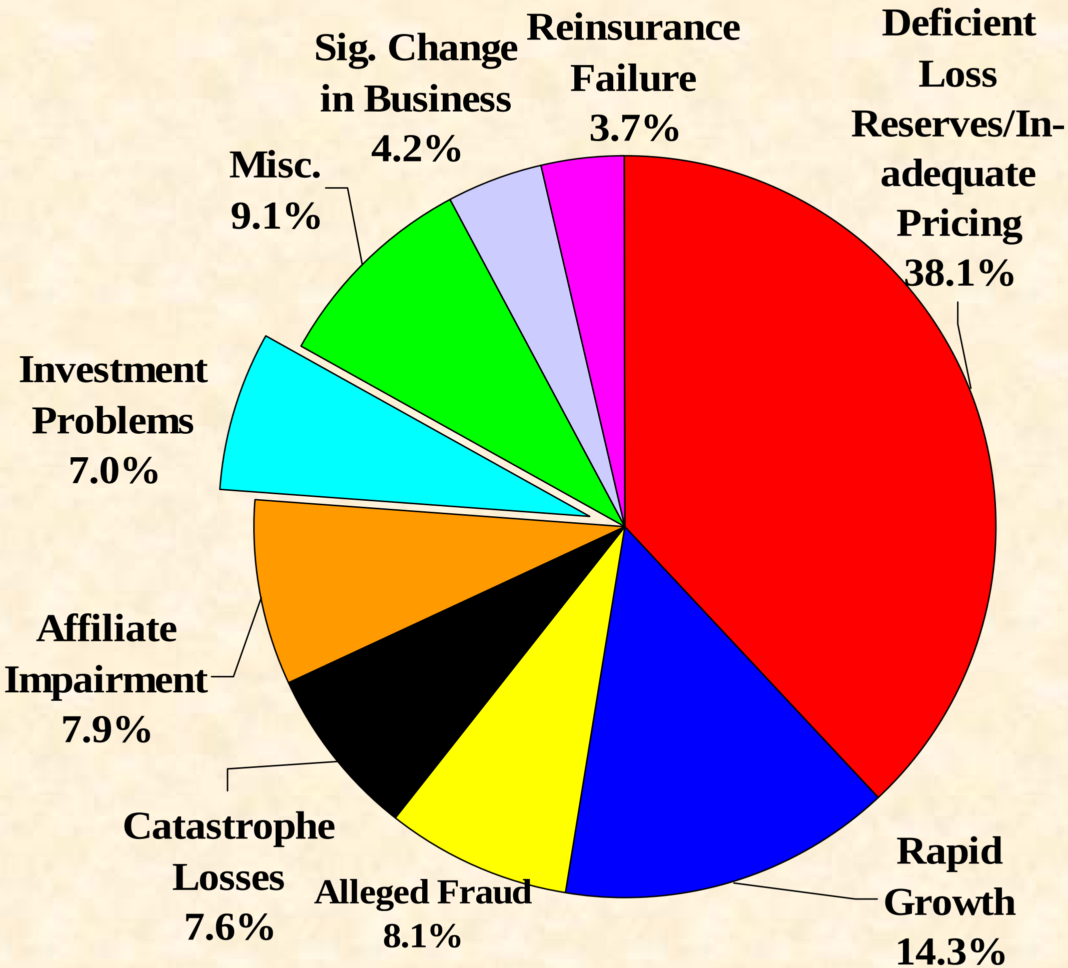
2000



P/C insurer financial strength has improved since 2005 despite financial crisis

Source: A.M. Best: *Rating Downgrades Slowed but Outpaced Upgrades for Fourth Consecutive Year,* Special Report, November 8, 2004 for 2000; 2006 and 2009 *Review & Preview*. *Ratings 'B' and lower.

Reasons for US P/C Insurer Impairments, 1969-2008



Deficient loss reserves and inadequate pricing are the leading cause of insurer impairments, underscoring the importance of discipline. Investment catastrophe losses play a much smaller role.

Source: A.M. Best: *1969-2008 Impairment Review*, Special Report, Apr. 6, 2008

Critical Differences Between P/C Insurers and Banks

Superior Risk Management Model & Low Leverage Make a Big Difference

How Insurance Industry Stability Has Benefitted Consumers

BOTTOM LINE:

- **Insurance Markets—Unlike Banking—Are Operating *Normally***
- **The Basic Function of Insurance—the Orderly Transfer of Risk from Client to Insurer—Continues *Uninterrupted***
- **This Means that Insurers Continue to:**
  - **Pay claims (whereas 120 banks have gone under as of 9/25/09)**
    - ***The Promise is Being Fulfilled***
  - **Renew existing policies (banks are reducing and eliminating lines of credit)**
  - **Write new policies (banks are turning away people and businesses who want or need to borrow)**
  - **Develop new products (banks are scaling back the products they offer)**
  - **Compete Intensively (banks are consolidating, reducing consumer choice)**

Source: Insurance Information Institute

Reasons Why P/C Insurers Have Fewer Problems Than Banks: A Superior Risk Management Model

- ***Emphasis on Underwriting***
  - **Matching of risk to price (via experience and modeling)**
  - **Limiting of potential loss exposure**
  - ***Some banks sought to maximize volume and fees and disregarded risk***
- ***Strong Relationship Between Underwriting and Risk Bearing***
  - **Insurers always maintain a stake in the business they underwrite, keeping "skin in the game" at all times**
  - ***Banks and investment banks package up and securitize, severing the link between risk underwriting and risk bearing, with (predictably) disastrous consequences—straightforward moral hazard problem from Econ 101***
- ***Low Leverage***
  - **Insurers do not rely on borrowed money to underwrite insurance or pay claims →*****There is no credit or liquidity crisis in the insurance industry***
- ***Conservative Investment Philosophy***
  - **High quality portfolio that is relatively less volatile and more liquid**
- ***Comprehensive Regulation of Insurance Operations***
  - **The business of insurance remained comprehensively regulated whereas a separate banking system had evolved largely outside the auspices and understanding of regulators (e.g., hedge funds, private equity, complex securitized instruments, credit derivatives—CDS's)**
- ***Greater Transparency***
  - **Insurance companies are an open book to regulators and the public**

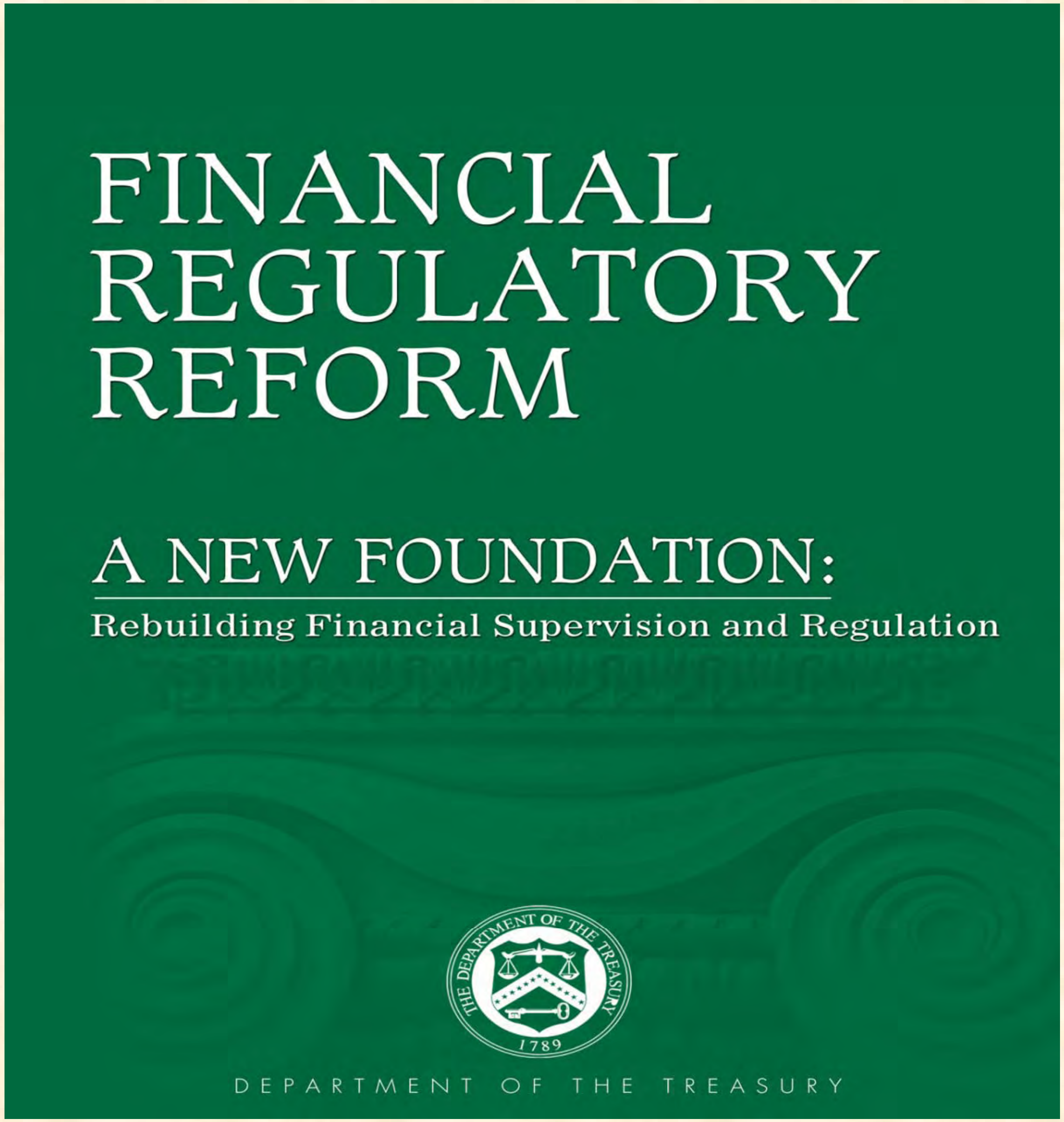
Source: Insurance Information Institute

Regulatory Reform

Obama Administration's Plan for Reforming Financial Services Industry Regulation Will Impact Insurers

Status: Stalled in Congress

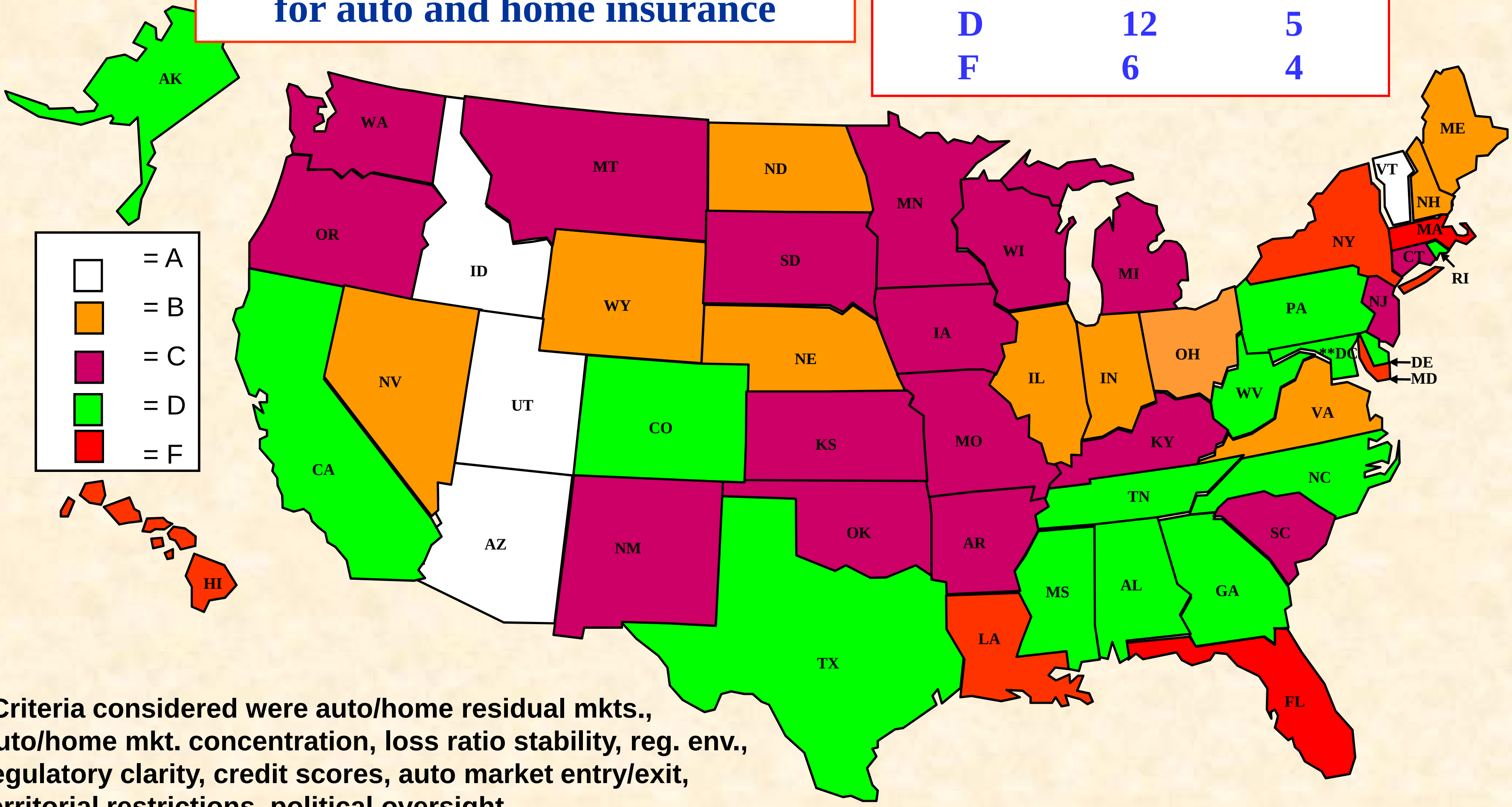
REGULATORY REFORM: 2009 AND BEYOND



*Rating of Auto/Home Insurance Regulatory & Operating Environment**

Study suggest the insurance regulatory and operating environments deteriorated in 2009 for auto and home insurance

GRADE	2009	2008
A	4	7
B	10	25
C	17	10
D	12	5
F	6	4



*Criteria considered were auto/home residual mkts., auto/home mkt. concentration, loss ratio stability, reg. env., regulatory clarity, credit scores, auto market entry/exit, territorial restrictions, political oversight.

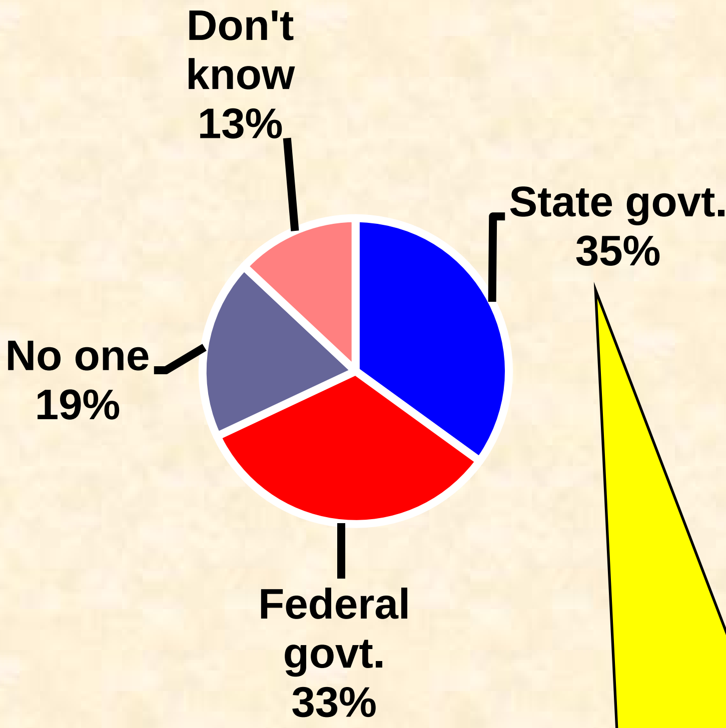
**Information not available.

Source: Heartland Institute, May 2009

http://www.heartland.org/custom/semod_policybot/pdf/25091.pdf

CONSUMER POLL: 2009 I.I.I. PULSE SURVEY

The average American has little to no understanding of insurance regulation: 1/3 believe the industry is regulated by the federal government and nearly 20% believe it is unregulated

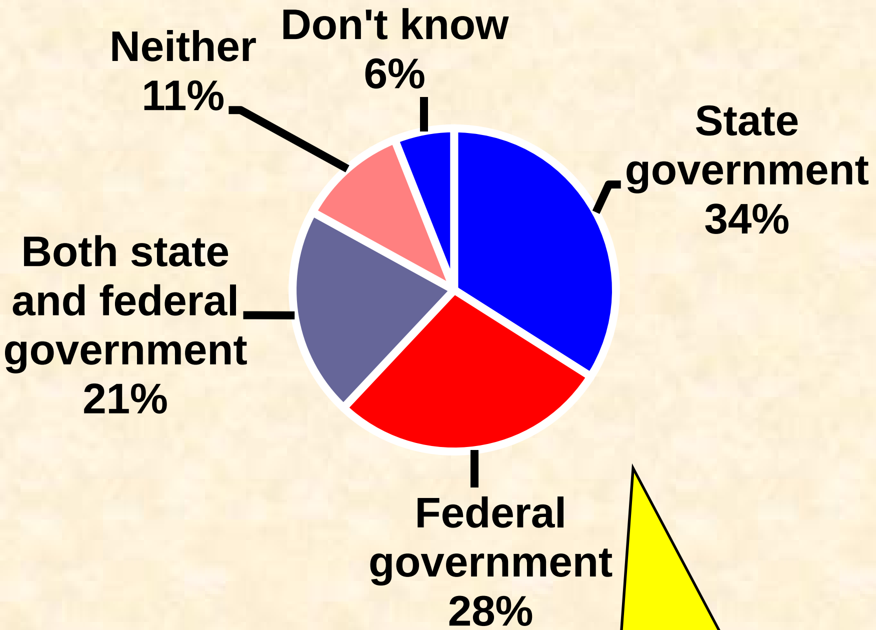


Barely 1/3 of Americans know that insurance is regulated by the states. There is a popular notion that the industry is unregulated.

Source: Insurance Information Institute, 2009 *Pulse* Survey, May 2009.

CONSUMER POLL: 2009 I.I.I. PULSE SURVEY

Americans are split on who they believe should regulate the insurance industry. More than 20% believe the industry should be regulated by both the state *and* federal government.



There is no strong support for state or federal regulation among the American public

Source: Insurance Information Institute, 2009 *Pulse* Survey, May 2009.

Obama Regulatory Reform Proposal: Plan Components

I. Office of National Insurance (ONI) Duties

1. Monitor “all aspects of the insurance industry”
2. Gather information
3. Identify the emergence of any problems or gaps in regulation that could contribute to a future crisis
4. Recommend to the Federal Reserve insurance companies it believes should be supervised as Tier 1 FHCs
5. Administer the Terrorism Risk Insurance Program
6. Authority to enter into international agreements and increase international cooperation on insurance regulation

Source: “Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation,” US Department of the Treasury, June 2009.

Obama Regulatory Reform Proposal: Plan Components (cont'd)

II. Systemic Risk Oversight & Resolution Authority

- Federal Reserve given authority to oversee systemic risk of large federal holding companies (Tier 1 FHCs)
  - Insurers are explicitly included among the types of entities that could be found to be a Tier 1 FHC
  - ONI given authority to "recommend to the Federal Reserve any insurance companies that the ONI believes should be supervised as Tier 1 FHC."
- Proposal also recommends "creation of a resolution regime to avoid disorderly resolution of failing bank holding companies, including Tier 1 FHCs "…in situations where the stability of the financial system is at risk." Directly affects insurers in 2 ways:
  - Resolution authority may extend to an insurer within the BHC structure if the BHC is failing
  - If systemically important insurer is failing (as identified by ONI as Tier 1 FHC) resolution authority may apply

Source: "Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation," US Department of the Treasury, June 2009.

Obama Regulatory Reform Proposal: Plan Components (cont'd)

III. Consumer Financial Protection Agency (CFPA)

- Recommendation that "CFPA should have broad jurisdiction to protect consumers in consumer financial products and services such as credit, savings and payment products."
  - Appears that Administration does not intend that the CFPA have jurisdiction over the insurance industry products or market practices
  - At the same time, there is no language that expressly excludes insurance from the scope of the CFPA's authority
- CFPA proposal contains numerous references specific to credit and savings products but none to insurance. However, the Administration clearly anticipates that CFPA would have broad powers with the scope of the agency's agenda defined by several "Principles for Action," which clearly could apply to insurance regulation:
  - Transparency: Disclosures and communications with clients should be "reasonable"
  - Simplicity: Standards for simplified products, straightforward pricing
  - Fairness: Restrictions on products if benefits outweigh costs

Source: "Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation," US Department of the Treasury, June 2009; "Obama .Proposal Would Create Office of National Insurance But is Unclear on Federal Chartering," Dewey & LeBoeuf, *Client Alert*, June 17, 2009.

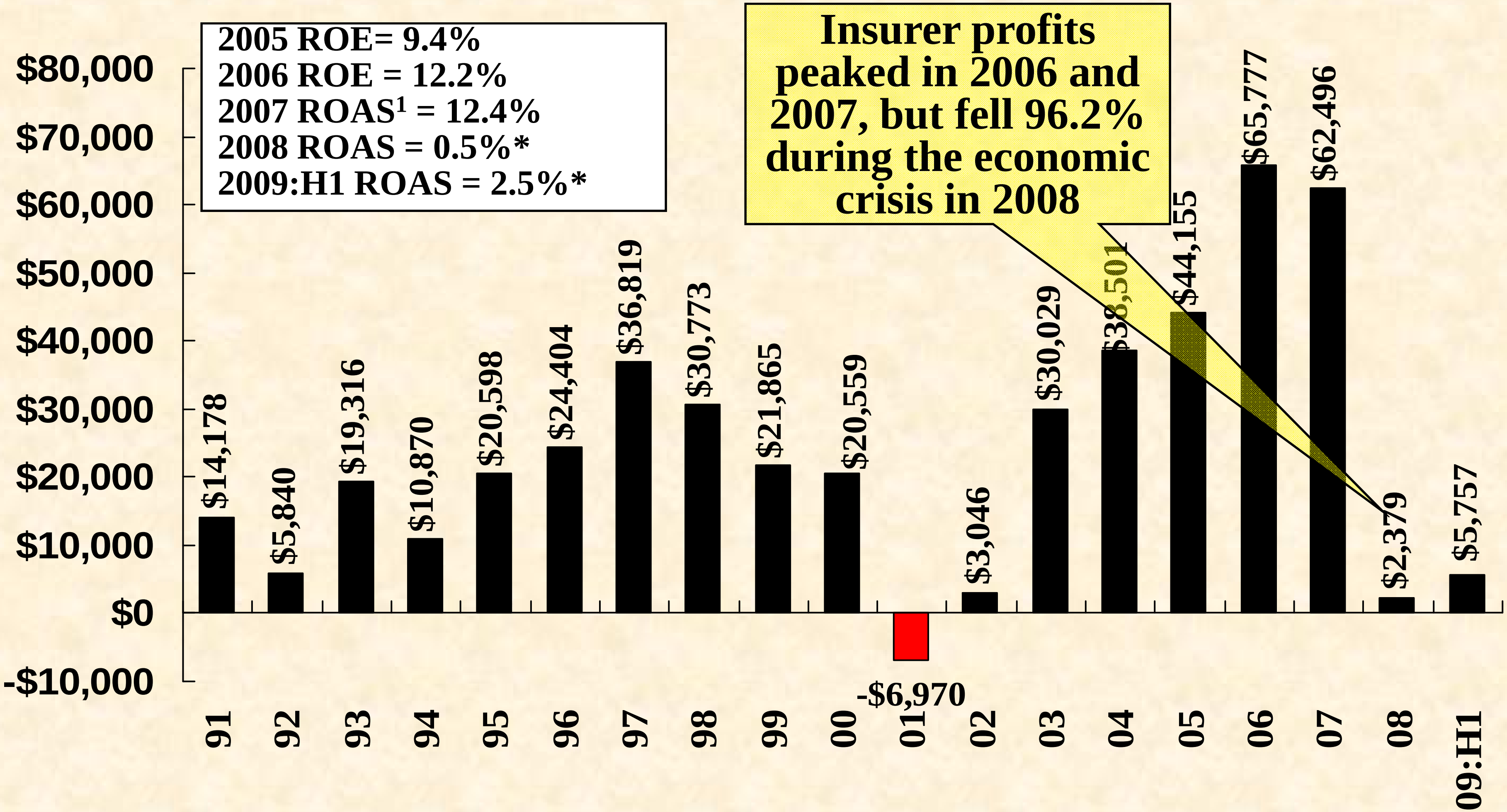
P/C INSURANCE FINANCIAL PERFORMANCE

A Resilient Industry in Challenging Times

Profitability

Historically Volatile

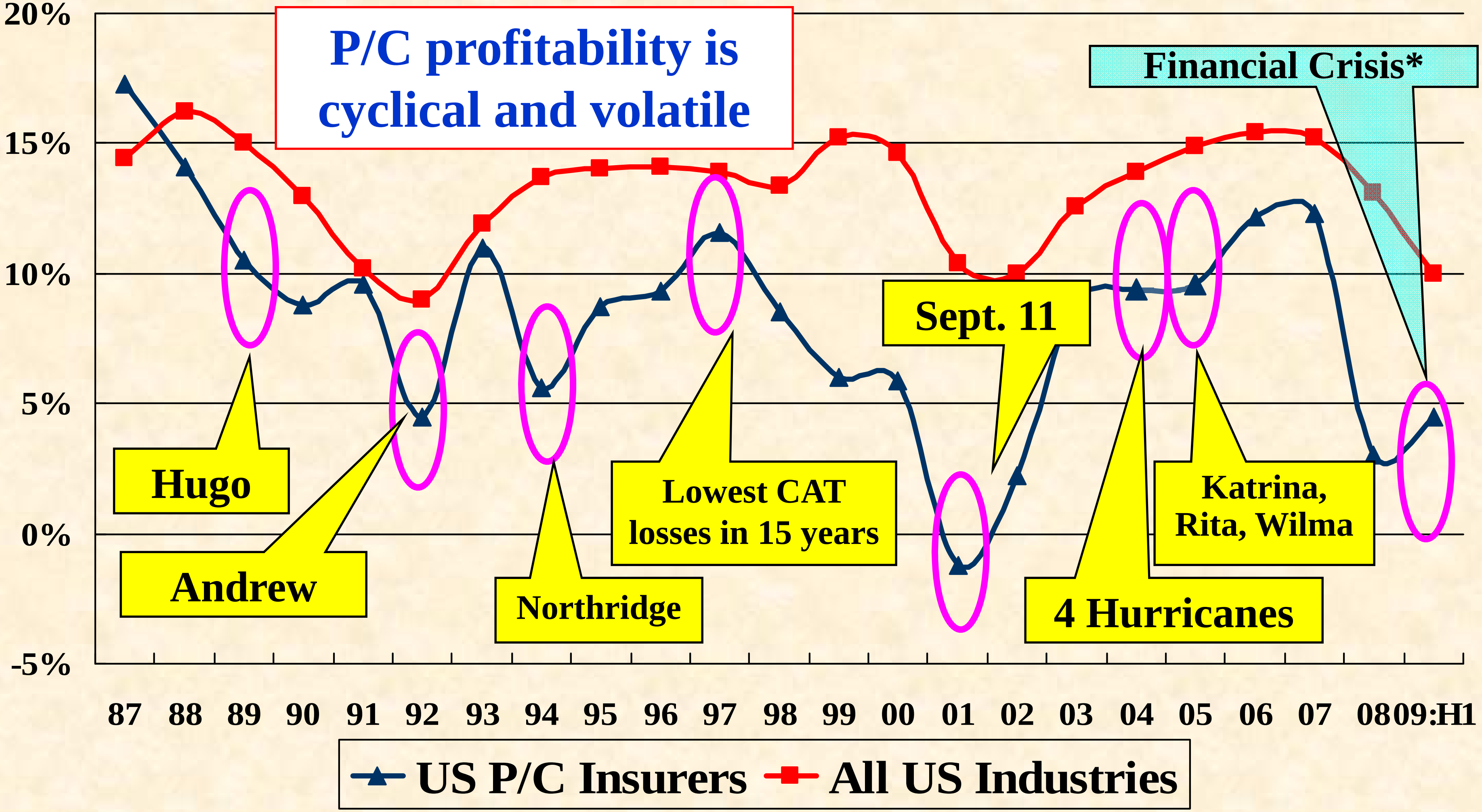
*P/C Net Income After Taxes 1991-2009:H1 ($ Millions)**



***ROE figures are GAAP; [1]Return on avg. surplus. Excluding Mortgage & Financial Guaranty insurers yields an 4.5% ROAS for 2008 and 2.2%. 2009:Q1 net income was $10.0 billion excl. M&FG.**

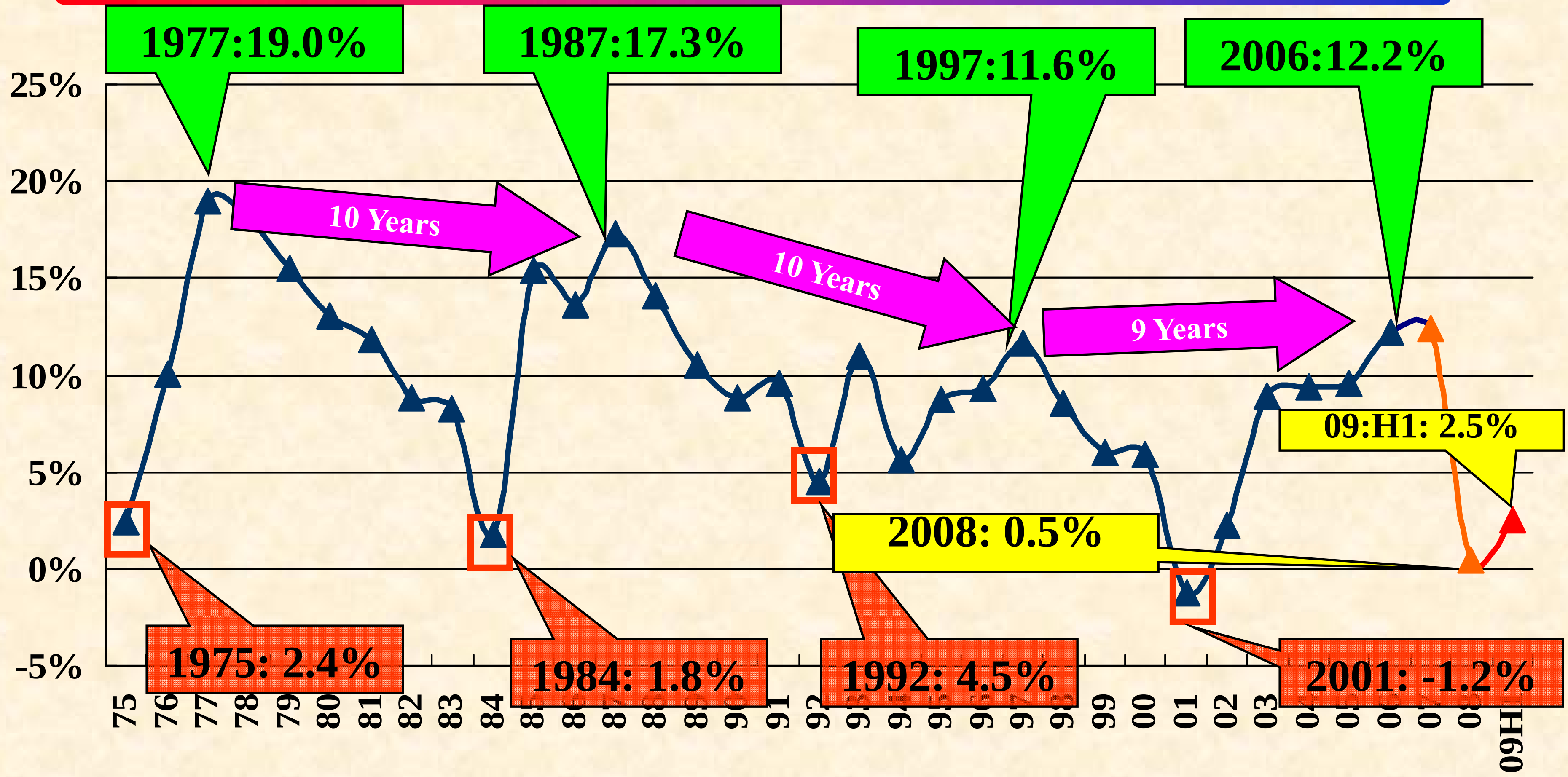
Sources: A.M. Best, ISO, Insurance Information Inst.

ROE: P/C vs. All Industries 1987–2009: H1*



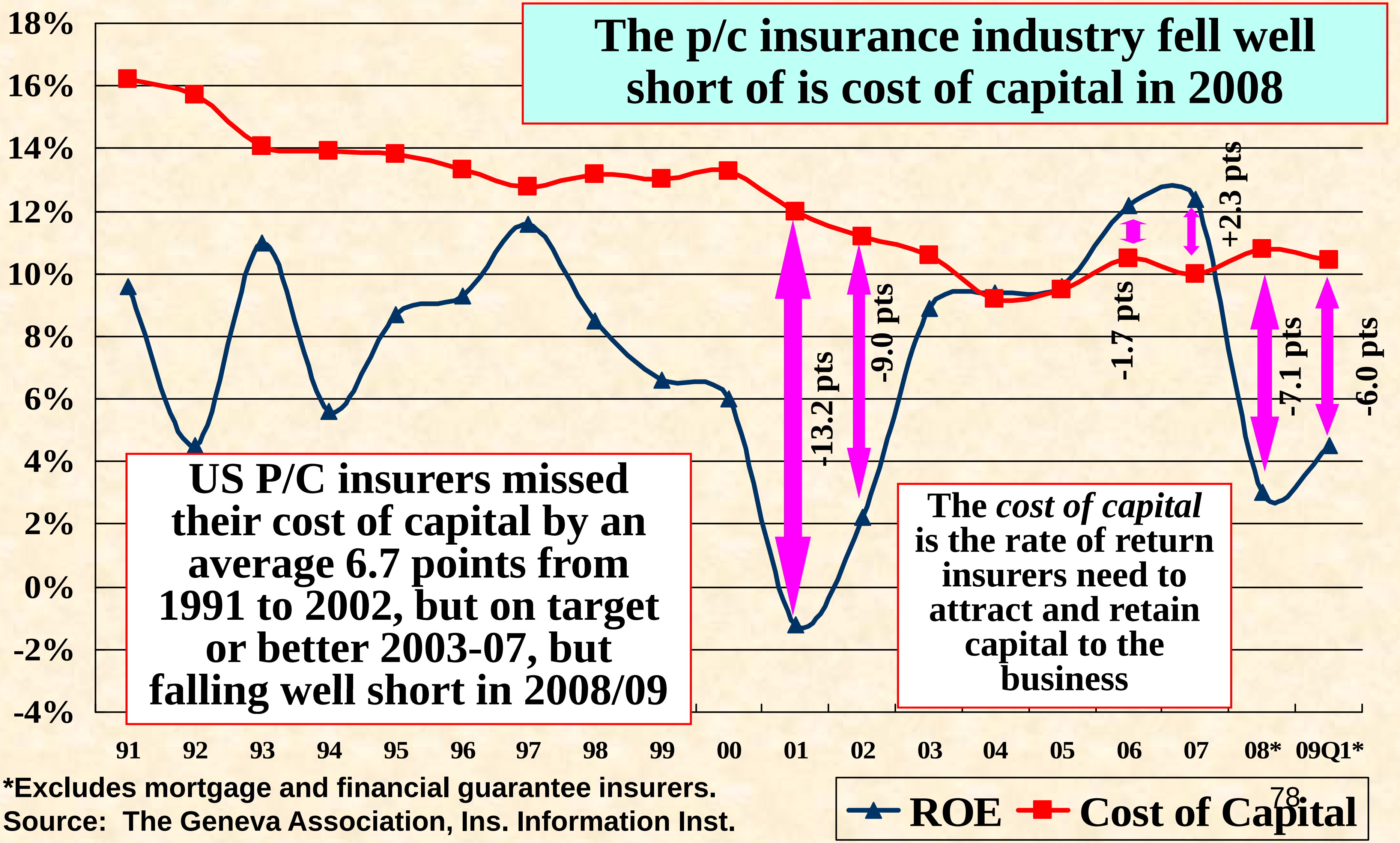
*Excludes Mortgage & Financial Guarantee in 2008 and 2009
Sources: ISO, *Fortune;* Insurance Information Institute.

*P/C Insurance Industry ROEs, 1975 – 2009:H1**



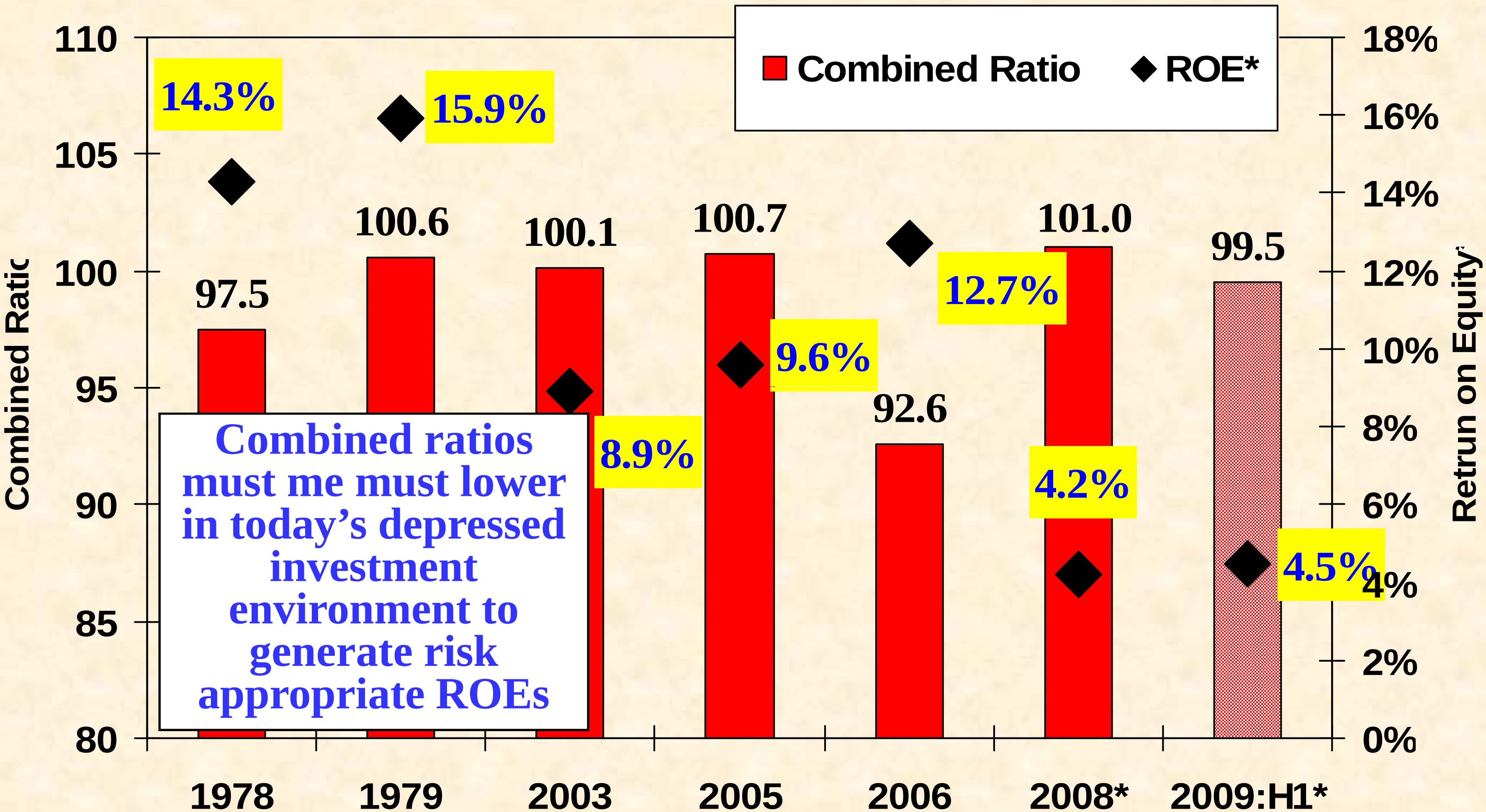
Note: 2008 result excluding Mortgage & Financial Guarantee insurers is 4.2% and 4.5% in H1 2009.
Sources: ISO; A.M. Best; Insurance Information Institute.

ROE vs. Equity Cost of Capital: US P/C Insurance:1991-2009:H1*



*Excludes mortgage and financial guarantee insurers.
Source: The Geneva Association, Ins. Information Inst.

A 100 Combined Ratio Isn't What it Used to Be: 95 is Where It's At

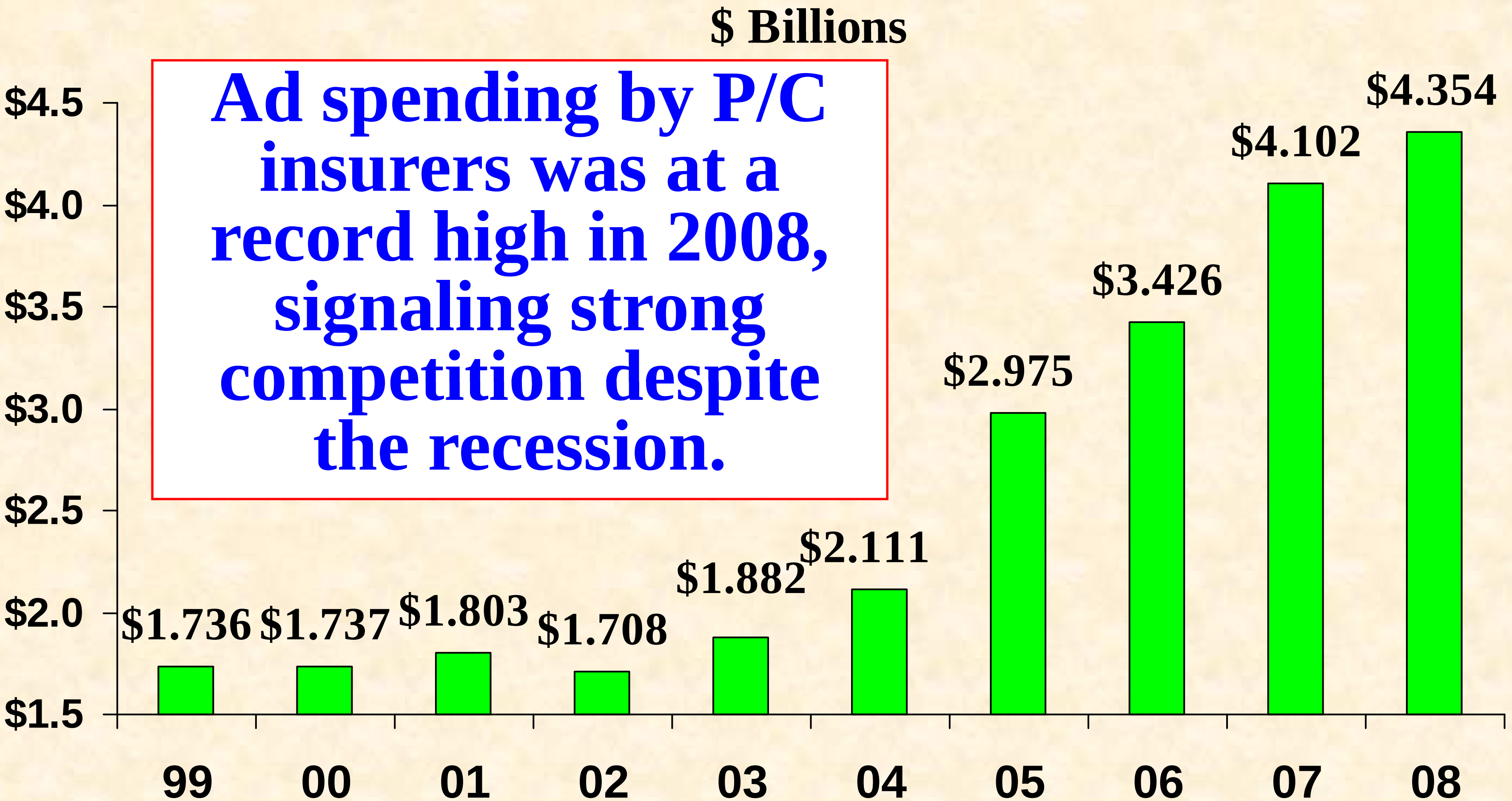


* 2008/9 figures are return on average statutory surplus. Excludes mortgage and financial guarantee insurers.

Source: Insurance Information Institute from A.M. Best and ISO data.

Advertising Trends

Advertising Expenditures by P/C Insurance Industry, 1999-2008

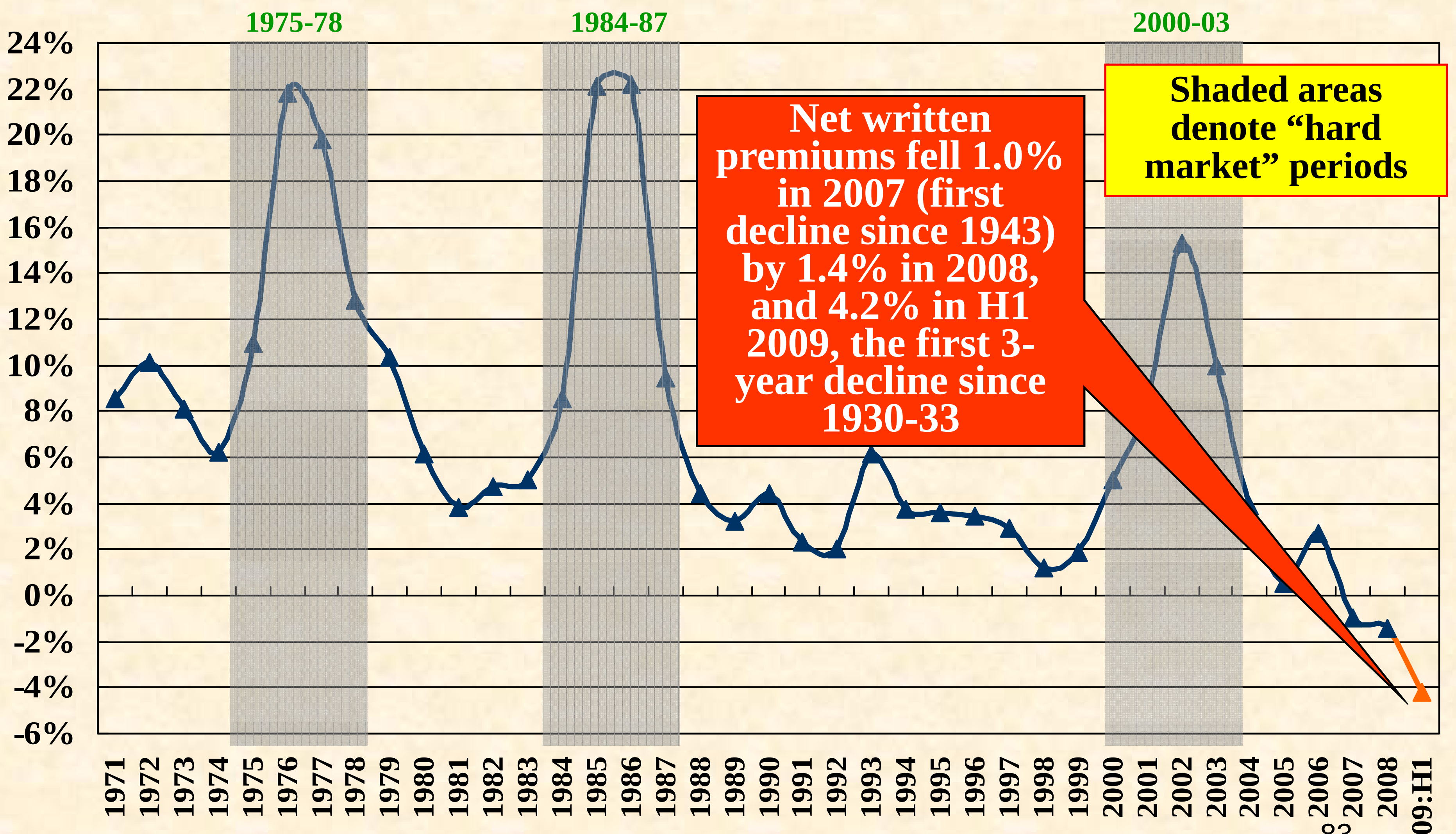


Source: Insurance Information Institute from consolidated P/C Annual Statement data.

P/C Premium Growth

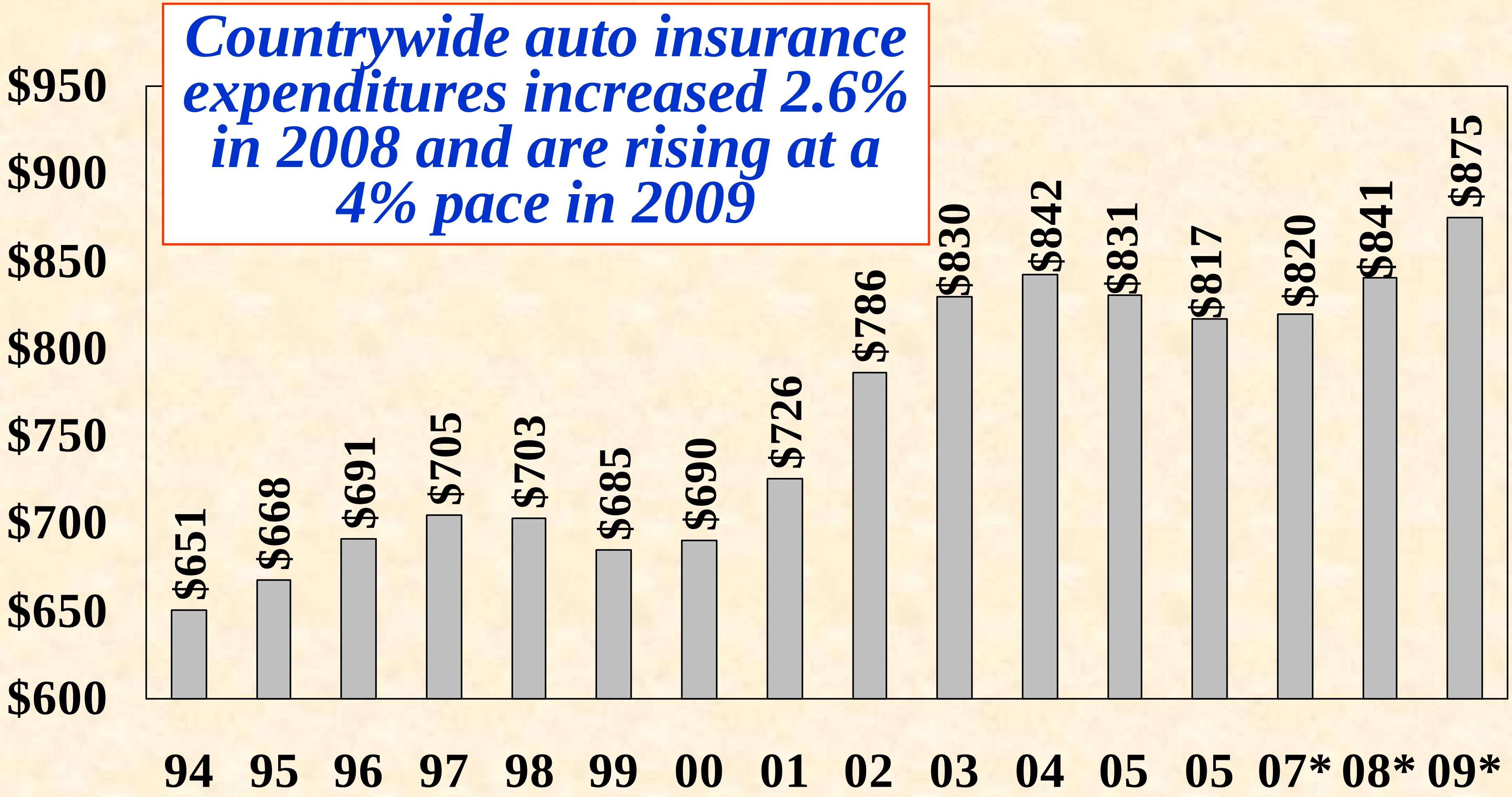
Primarily Driven by the Industry's Underwriting Cycle, Not the Economy

Strength of Recent Hard Markets by NWP Growth



Sources: A.M. Best (historical and forecast), ISO, Insurance Information Institute

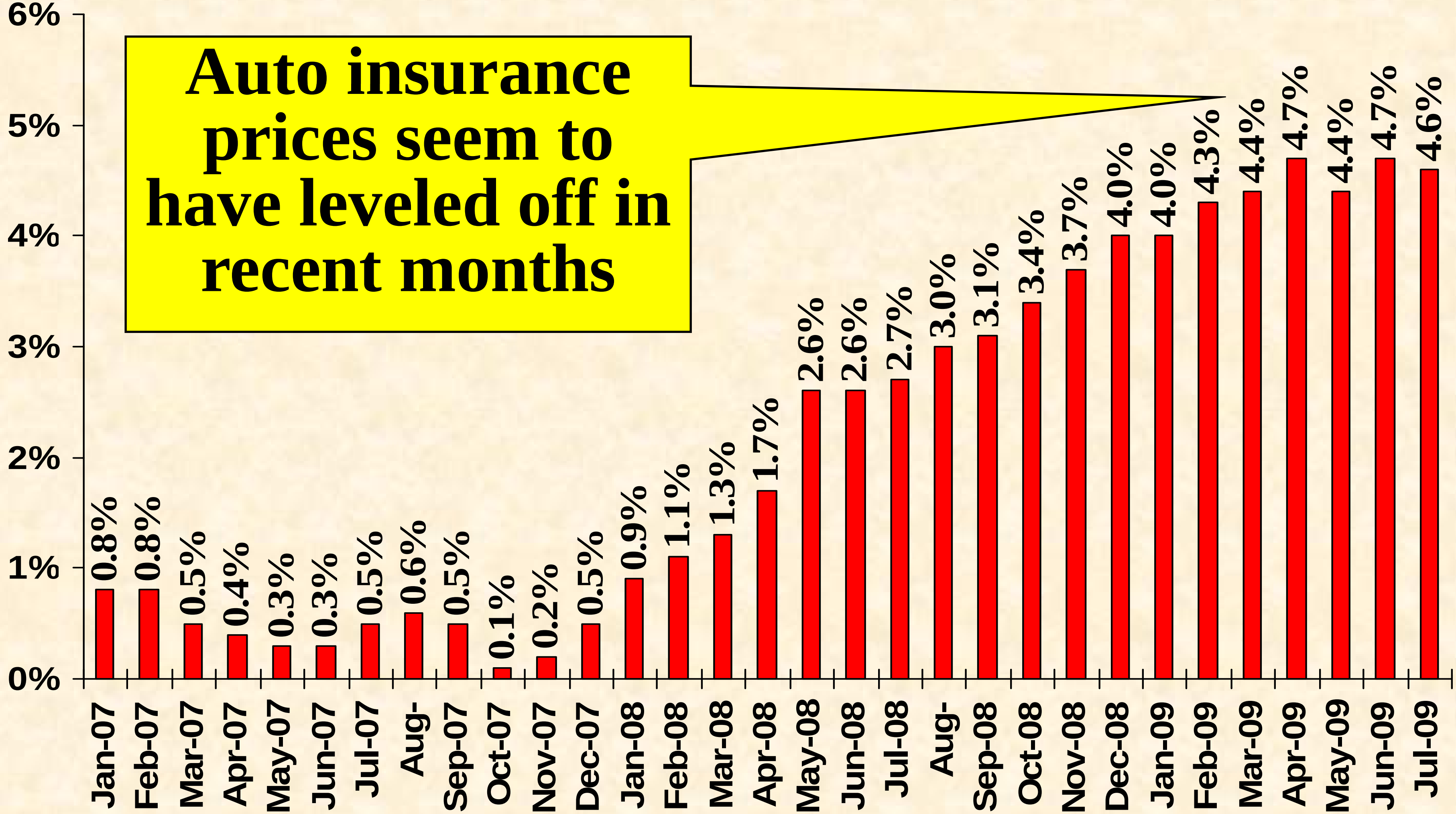
Average Expenditures on Auto Insurance



*Insurance Information Institute Estimates/Forecasts

Source: NAIC, Insurance Information Institute estimates 2007-2009 based on CPI data.

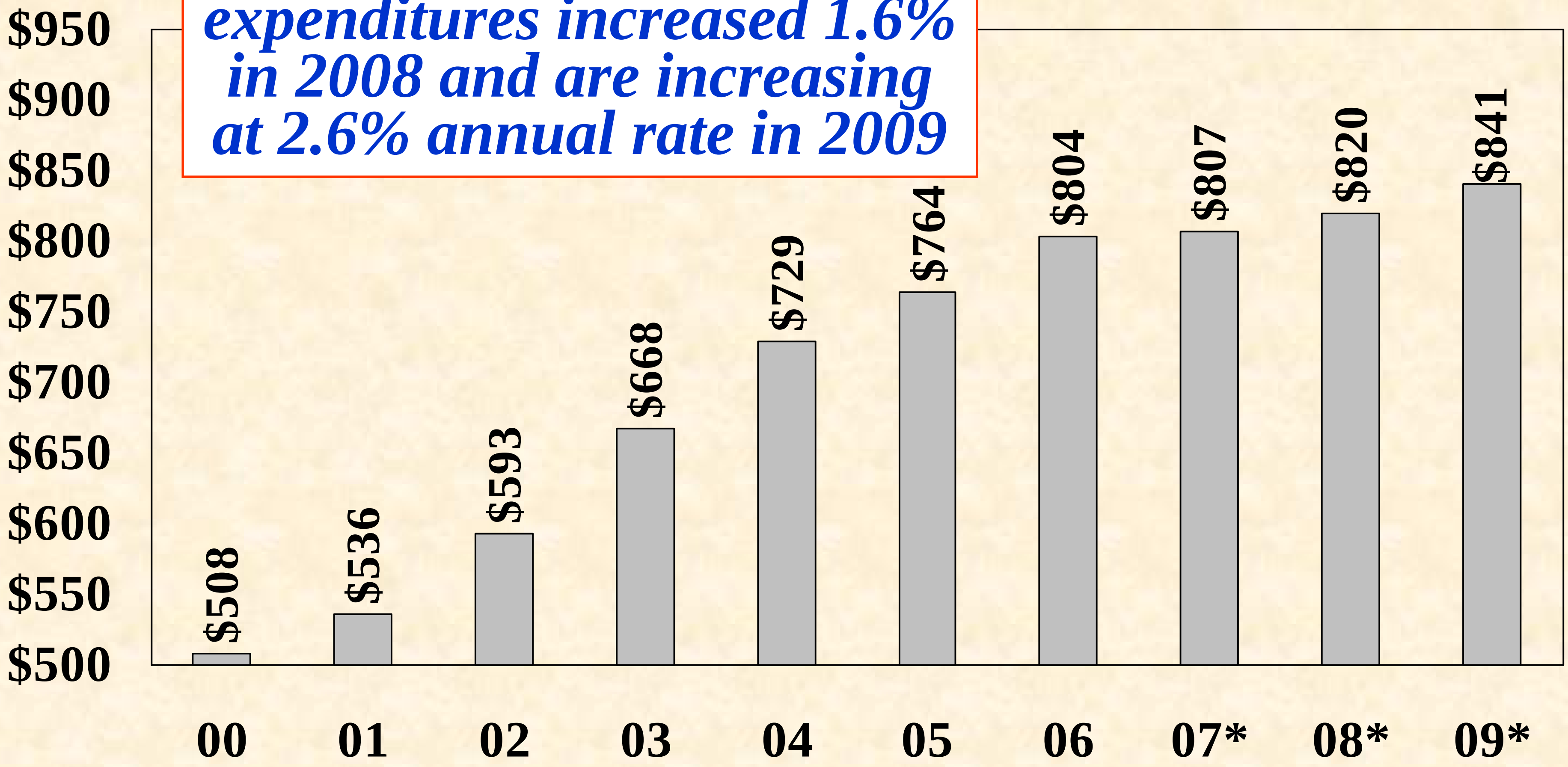
Monthly Change in Auto Insurance Prices*



***Percentage change from same month in prior year.**
Source: US Bureau of Labor Statistics

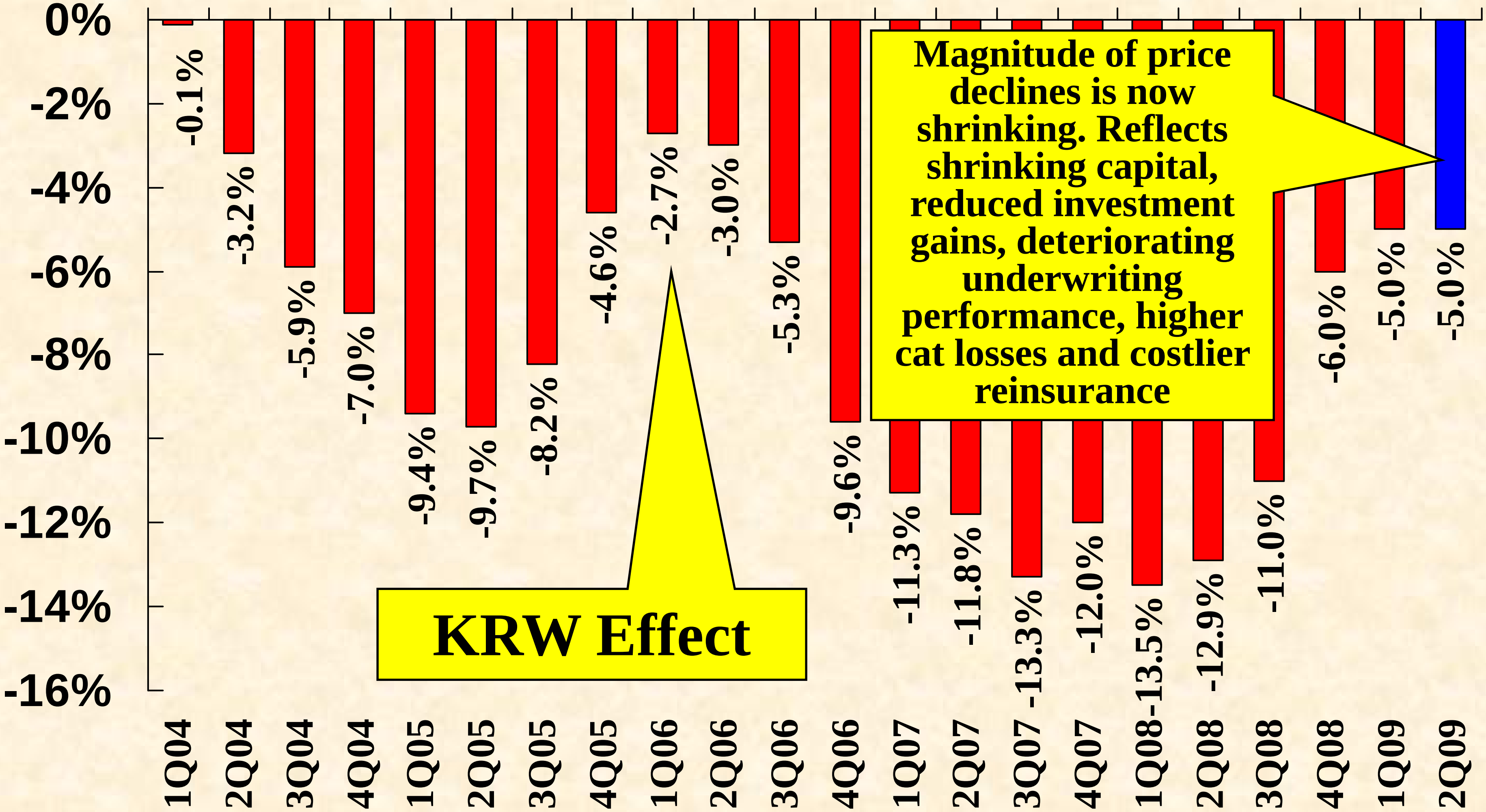
Average Premium for Home Insurance Policies**

Countrywide auto insurance expenditures increased 1.6% in 2008 and are increasing at 2.6% annual rate in 2009



***Insurance Information Institute Estimates/Forecasts **Excludes state-run insurers.**
Source: NAIC, Insurance Information Institute estimates 2007-2009 based on CPI data.

Average Commercial Rate Change, All Lines, (1Q:2004 – 2Q:2009)

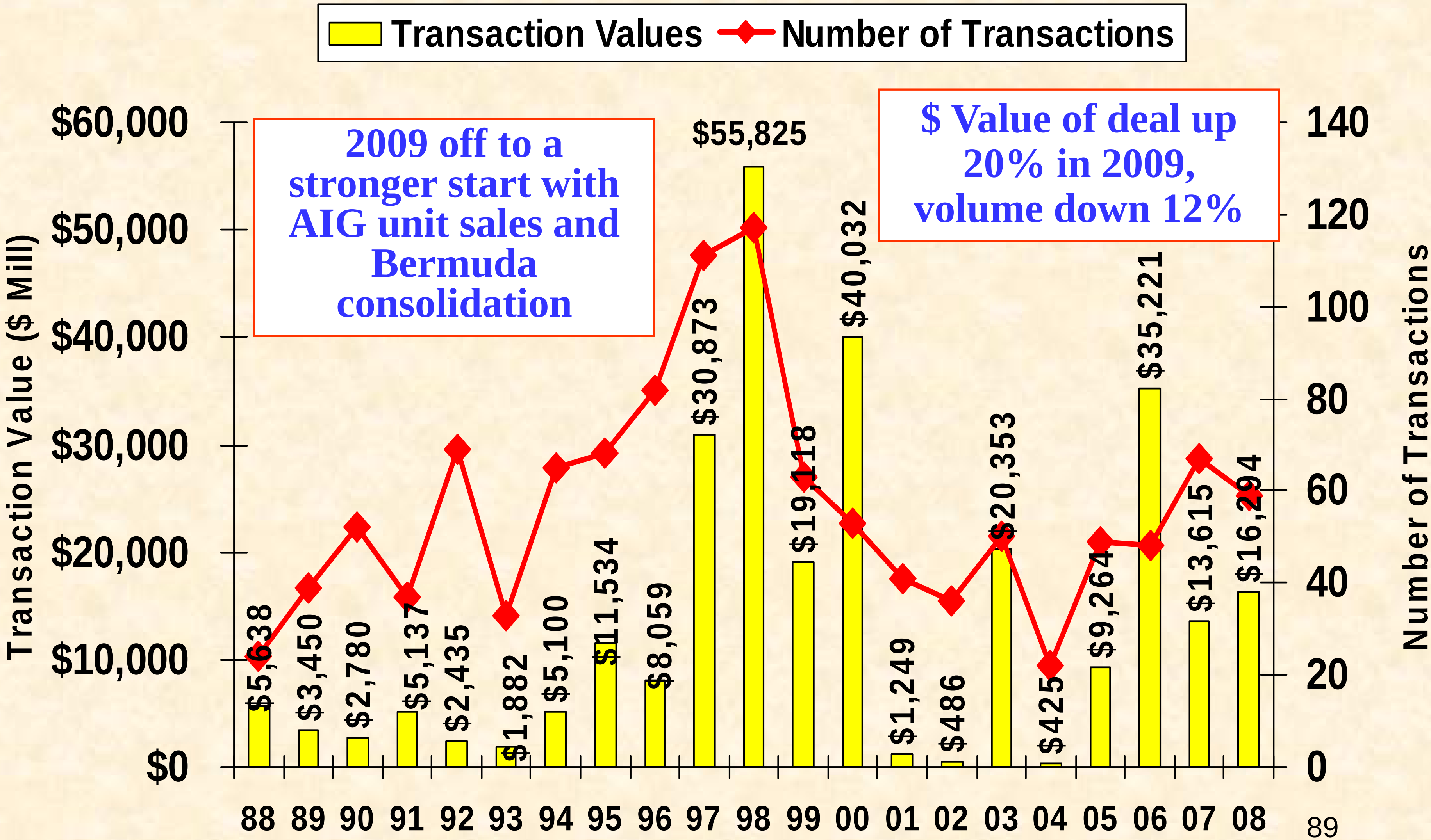


Source: Council of Insurance Agents & Brokers; Insurance Information Institute

Merger & Acquisition

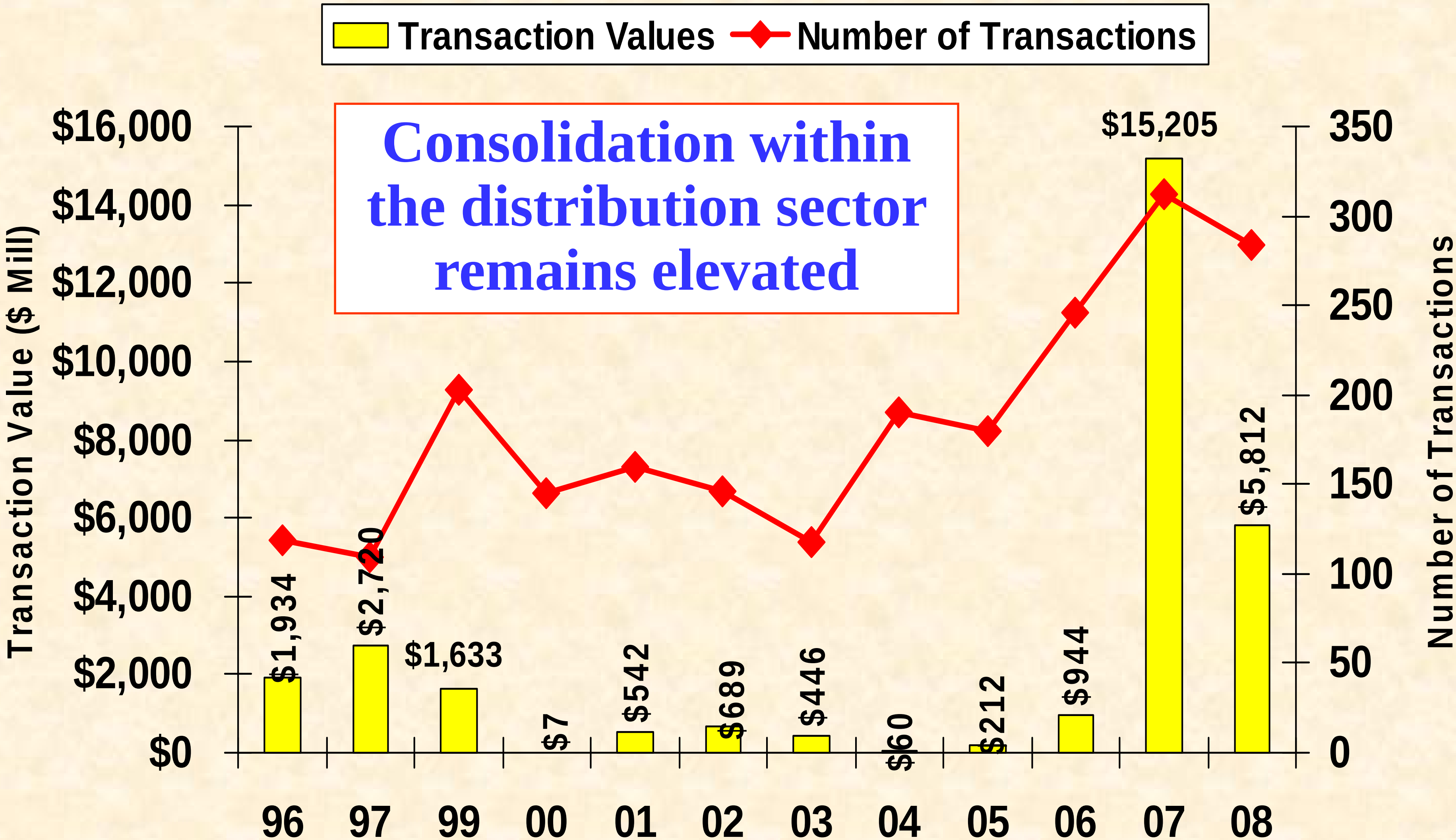
Barriers to Consolidation Will Diminish in 2009/10

P/C Insurance-Related M&A Activity, 1988-2008



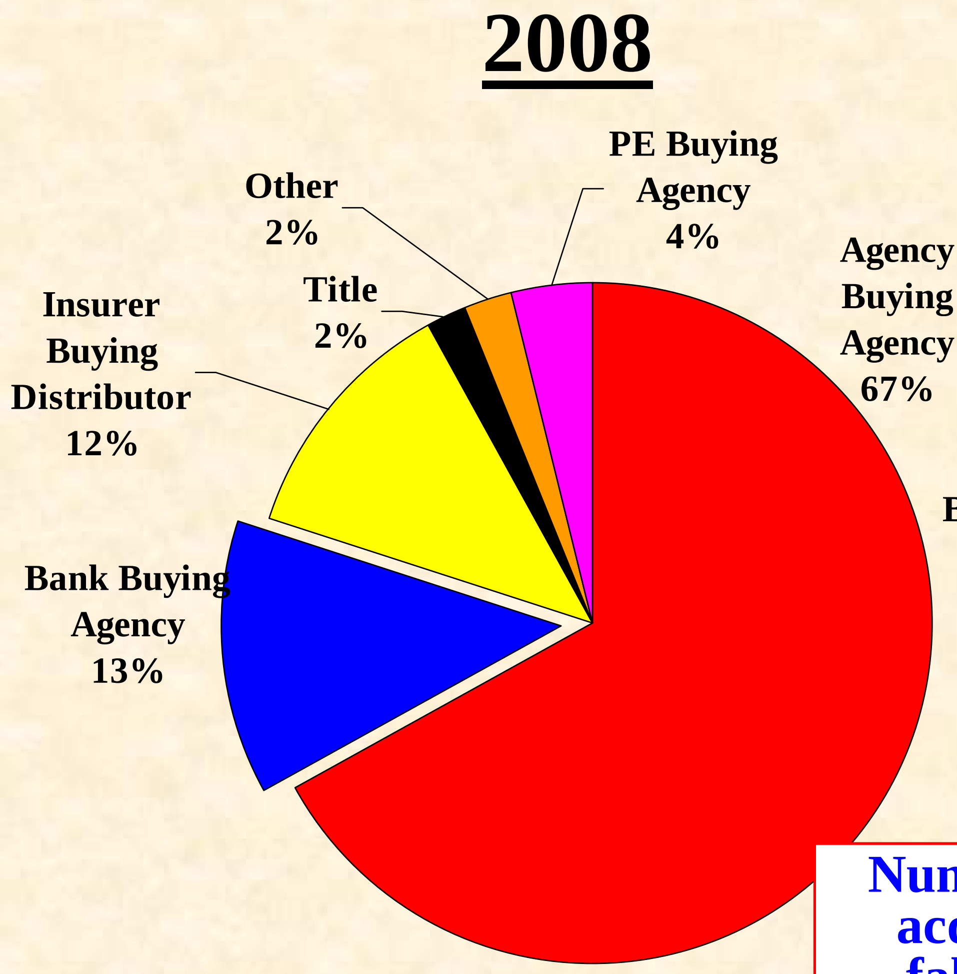
Source: Conning Research & Consulting.

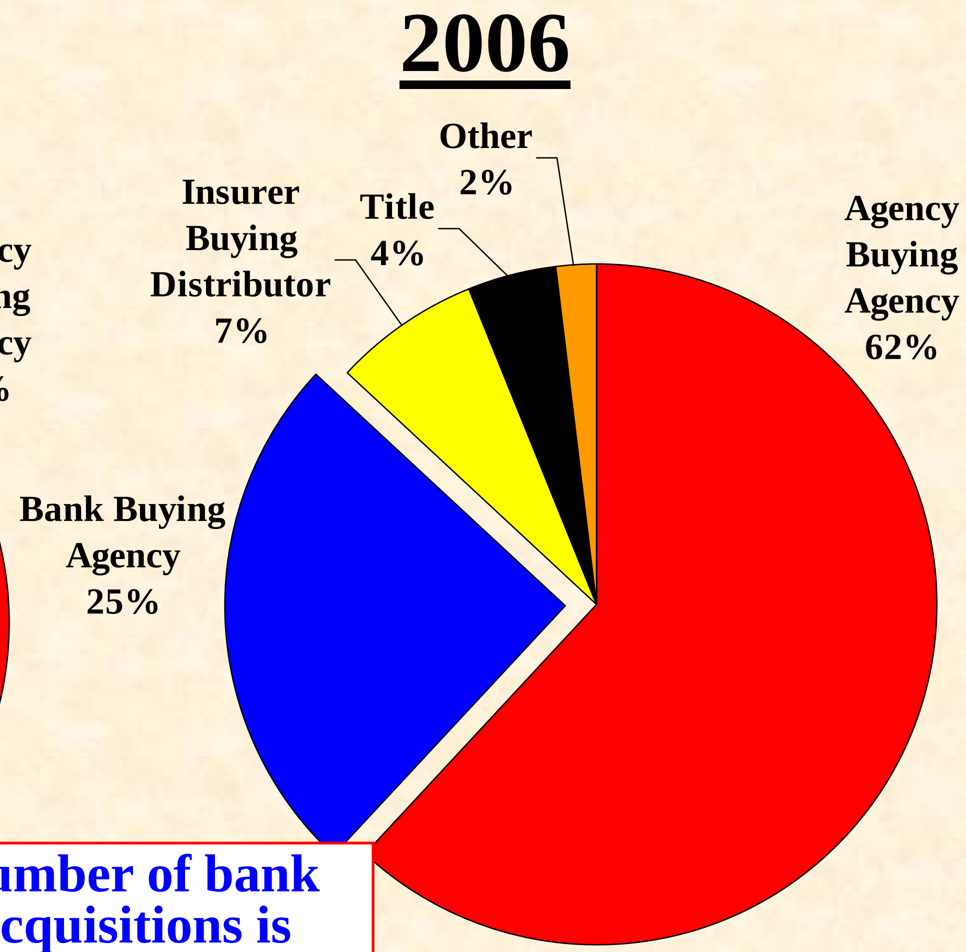
Distribution Sector: Insurance-Related M&A Activity, 1988-2008



Source: Conning Research & Consulting.

Distribution Sector M&A Activity, 2008 vs. 2006





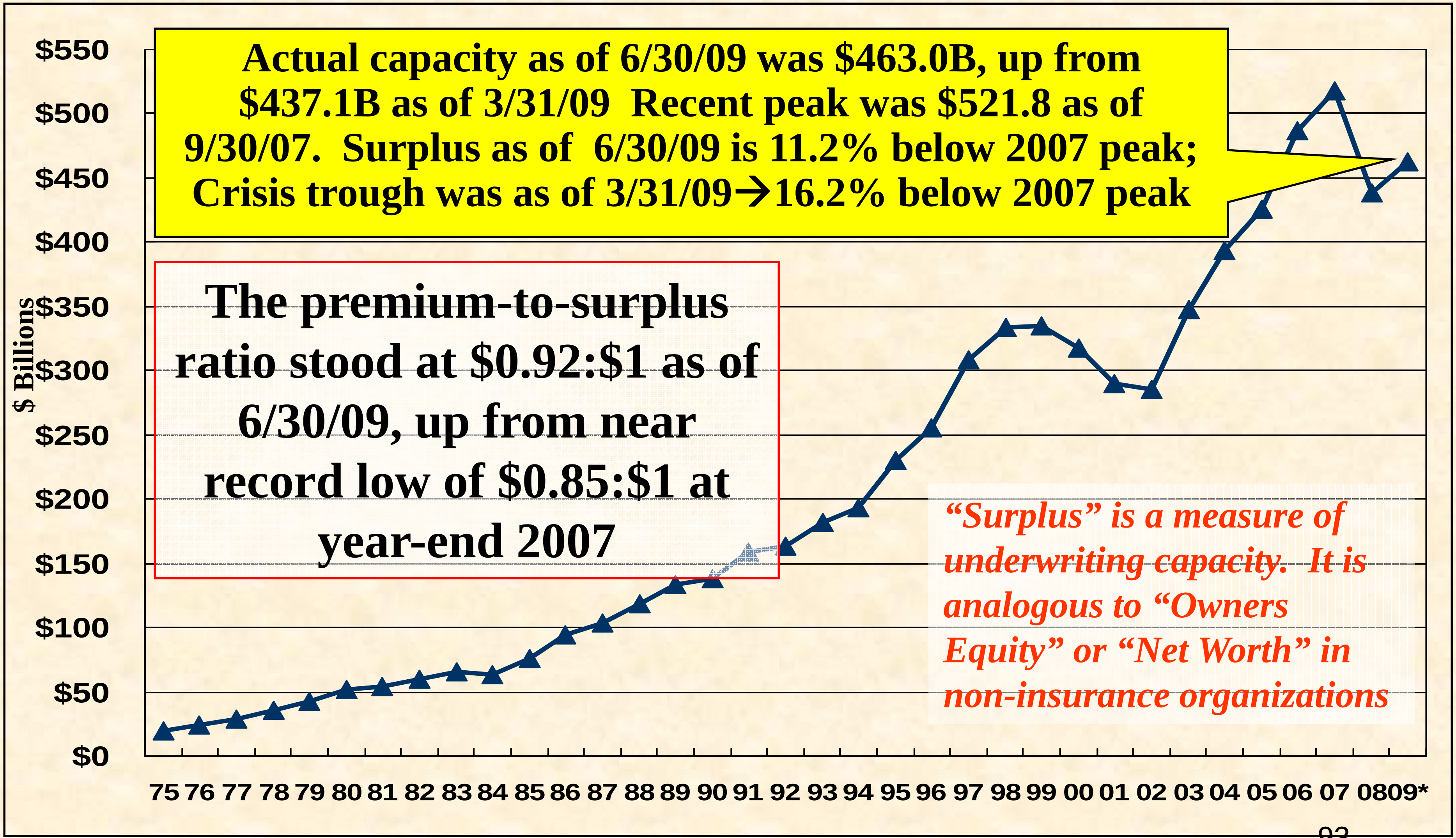
Number of bank acquisitions is falling; More private equity interest

Source: Conning Research & Consulting

Capital/ Policyholder Surplus (US)

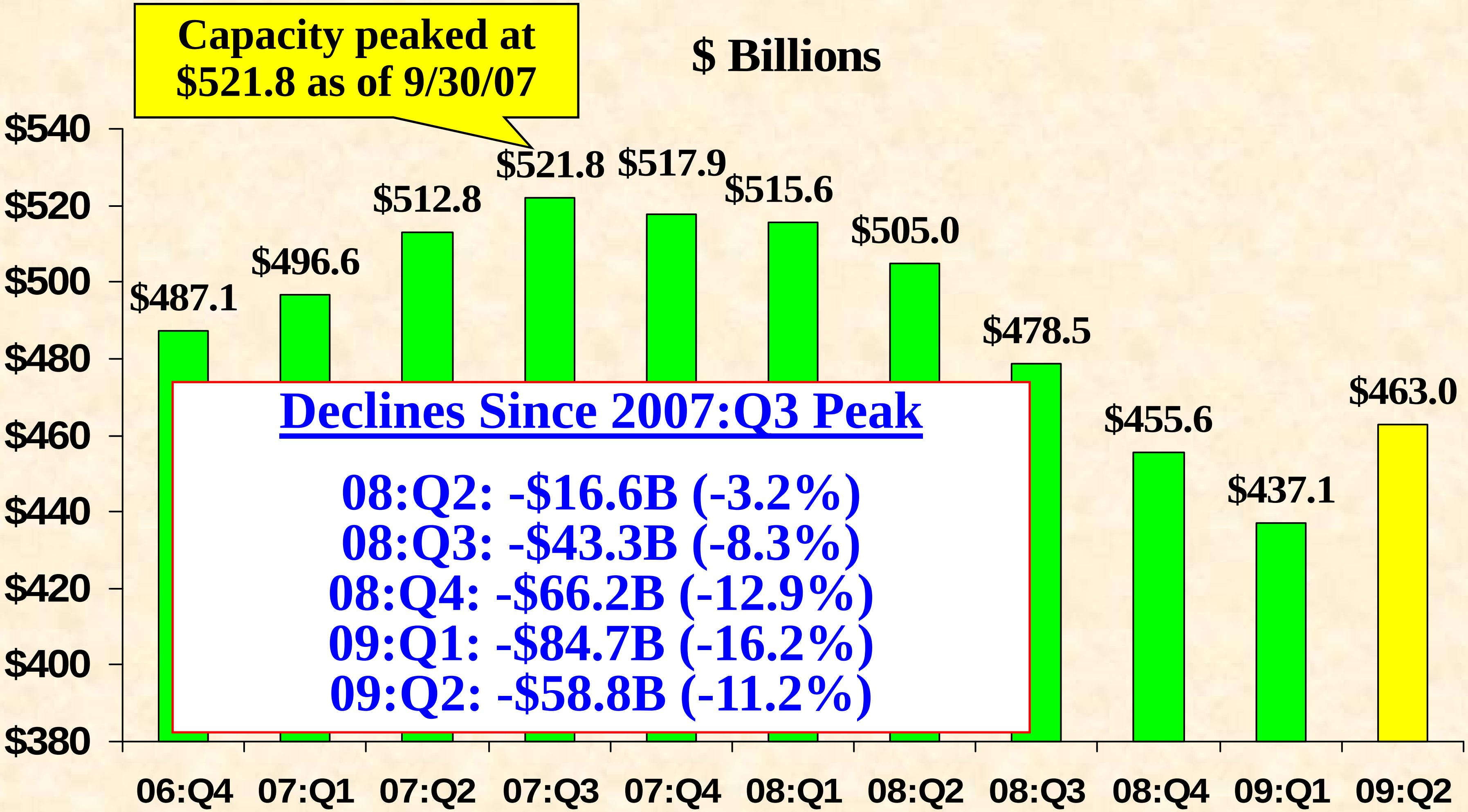
Shrinkage, but Capital is Within Historic Norms

U.S. Policyholder Surplus: 1975-2009:H1*



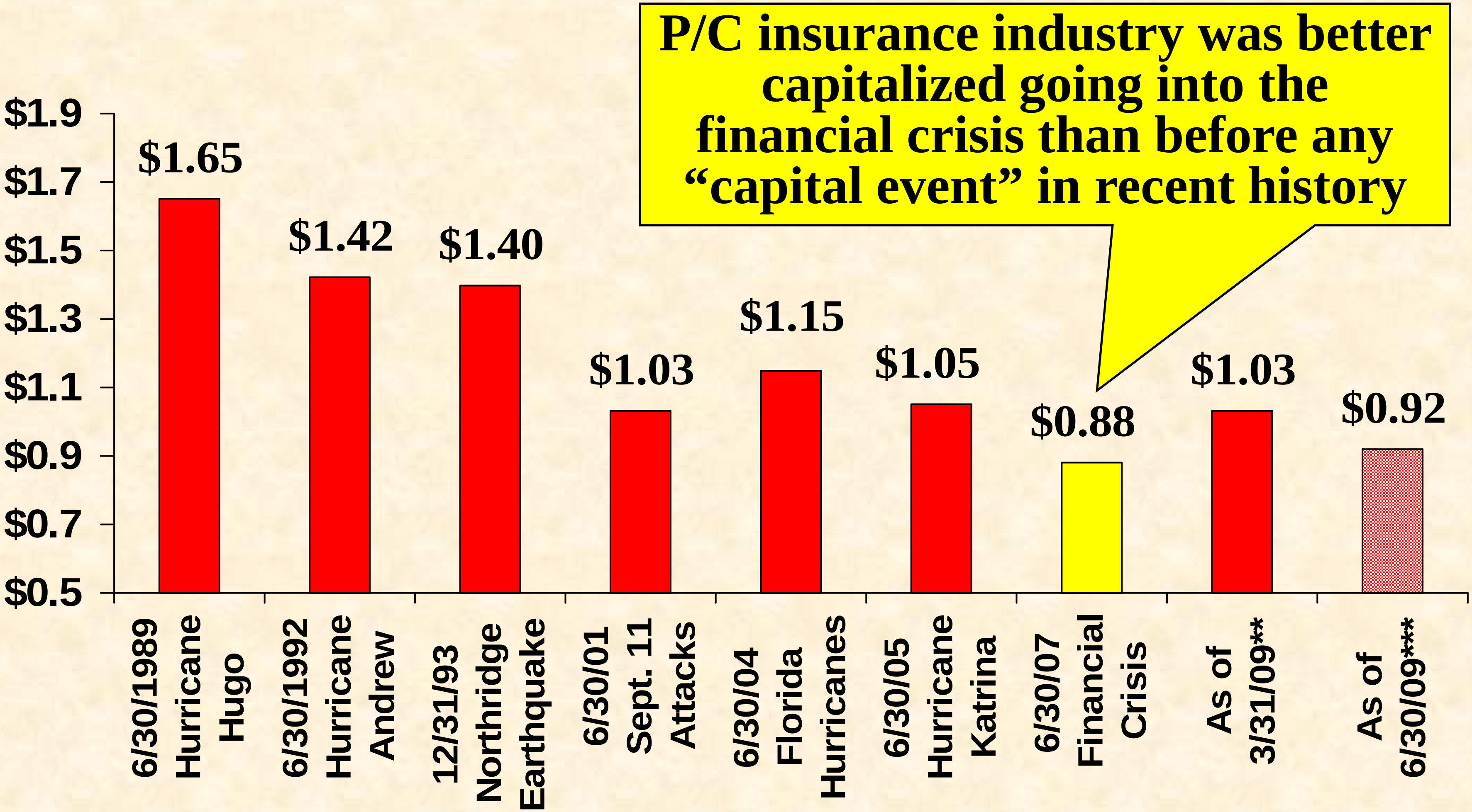
Source: A.M. Best, ISO, Insurance Information Institute. *As of 6/30/09

Policyholder Surplus,
2006:Q4 – 2009:H1



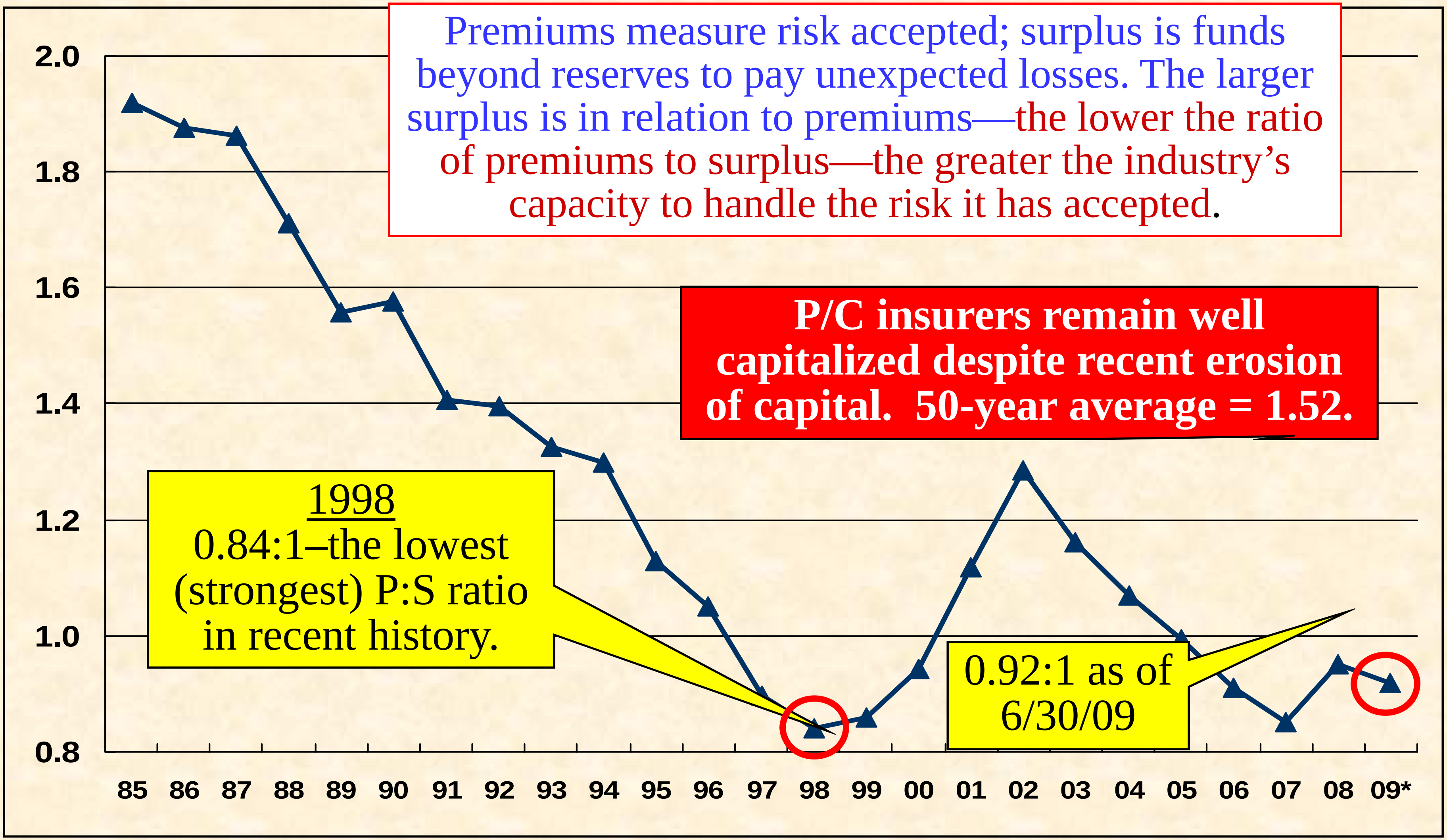
Source: ISO, AM Best.

Premium-to-Surplus Ratios Before Major Capital Events*



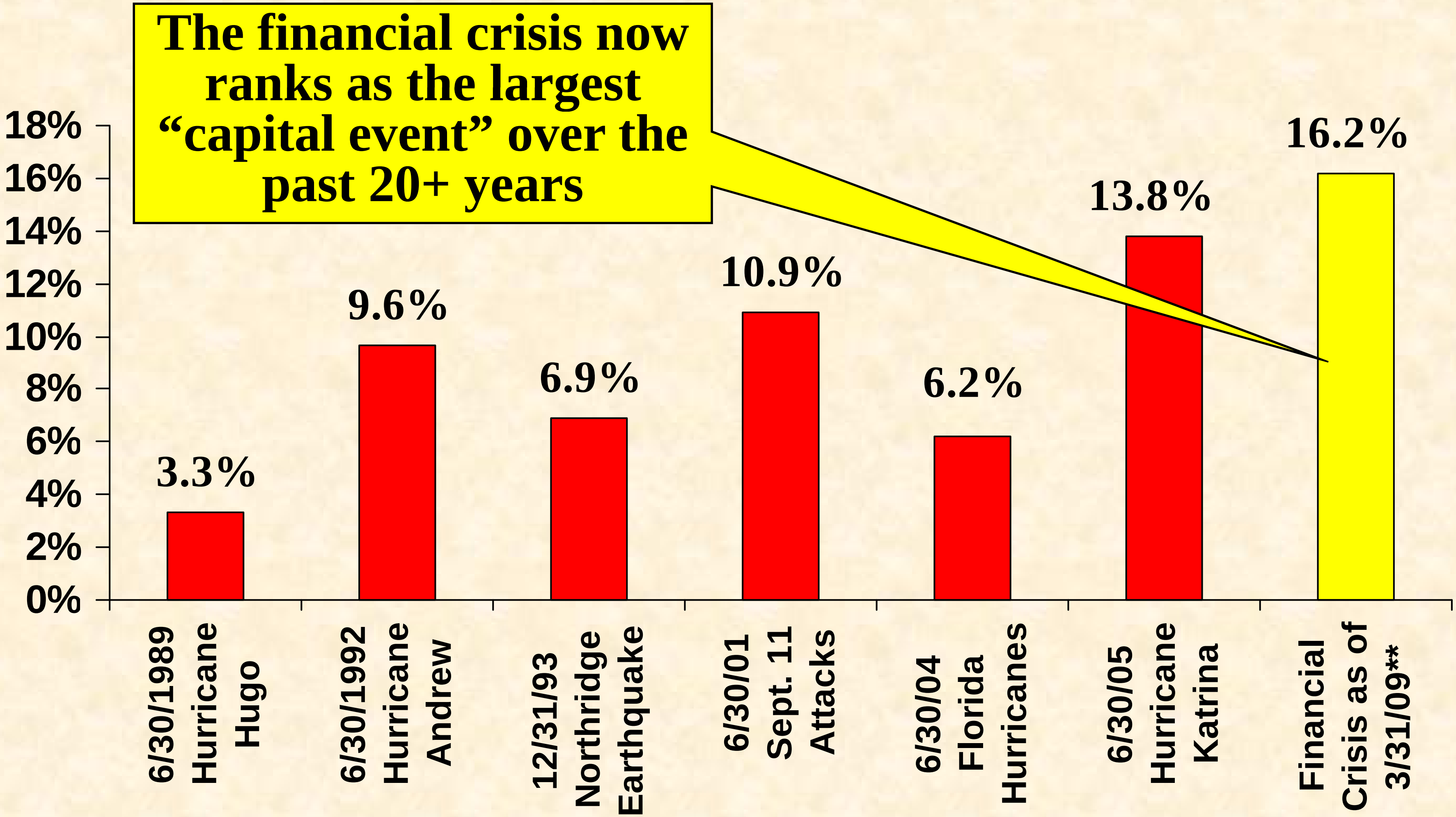
*Ratio is for end of quarter immediately prior to event. Date shown is end of quarter prior to event.
**Ratio at point of maximum capital erosion; ***Latest available
Source: PCS; Insurance Information Institute.

U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2009:H1



Sources: A.M. Best, ISO, Insurance Information Institute *As of 6/30/09.

Ratio of Insured Loss to Surplus for Largest Capital Events Since 1989*

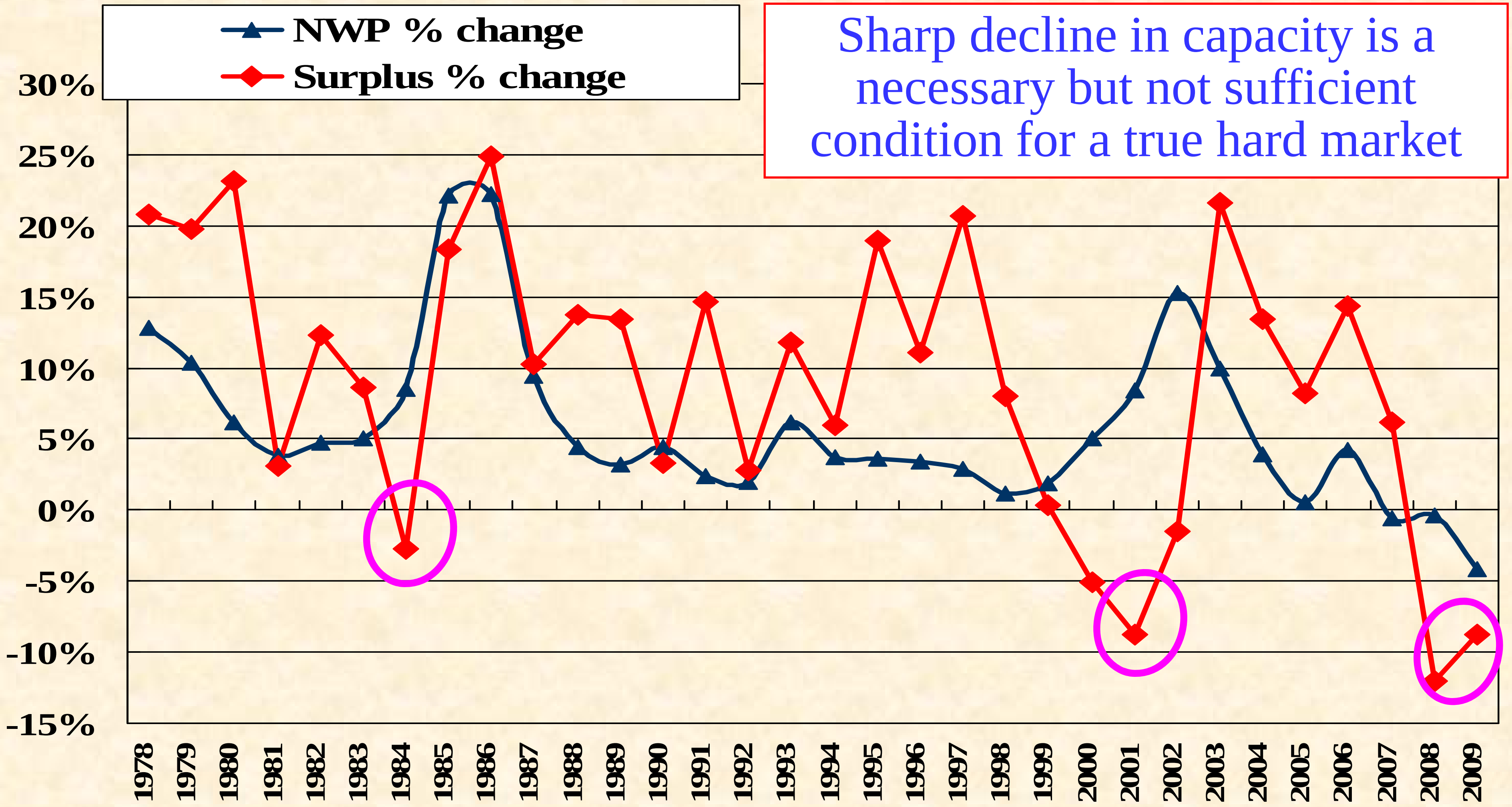


***Ratio is for end-of-quarter surplus immediately prior to event. Date shown is end of quarter prior to event.**

****Date of maximum capital erosion; As of 6/30/09 (latest available) ratio = 11.2%.**

Source: PCS; Insurance Information Institute.

Historically, Hard Markets Follow When Surplus "Growth" is Negative*



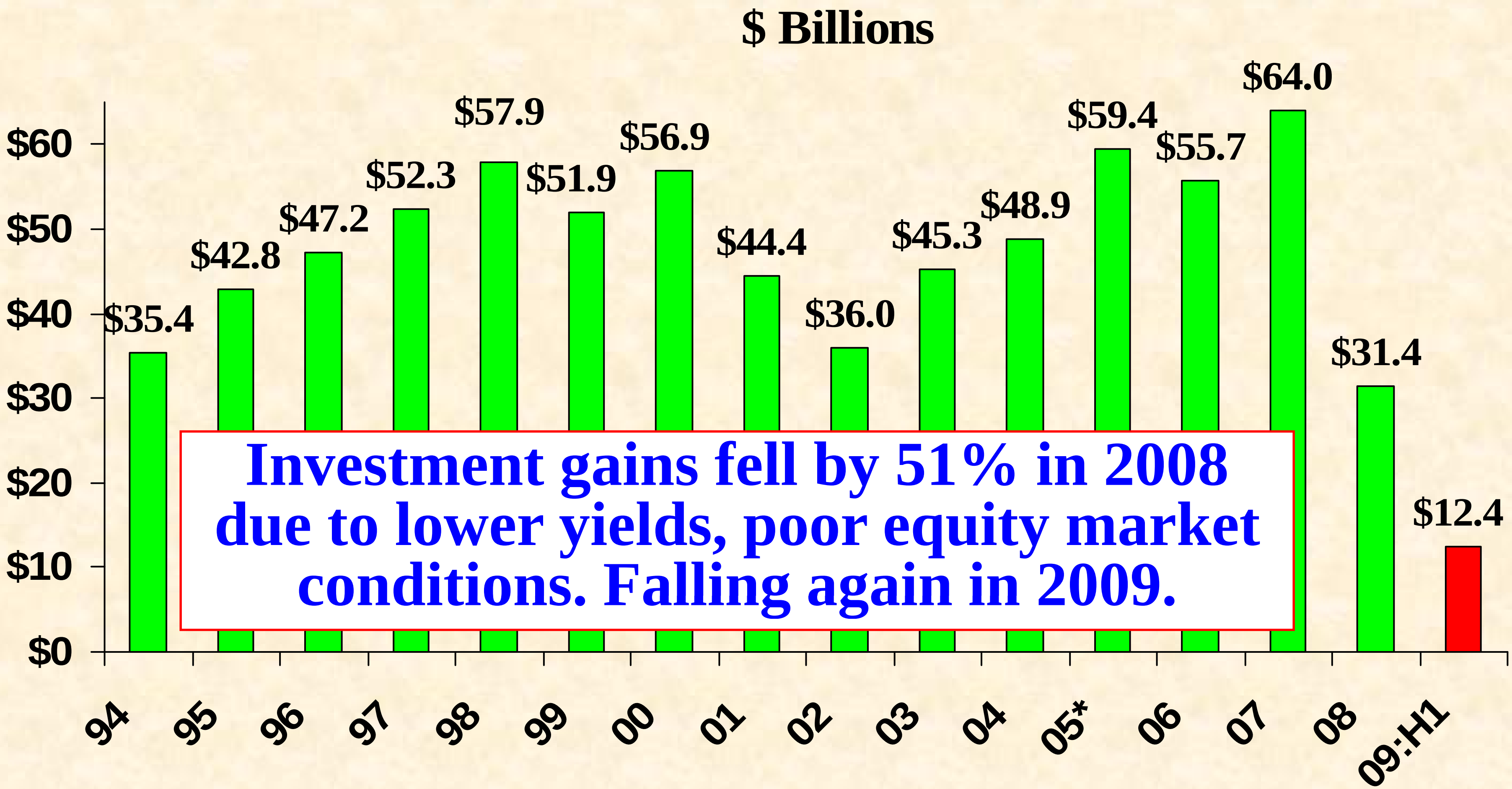
*2009 NWP and Surplus figures are % changes for H1:09 vs H1:08

Sources: A.M. Best, ISO, Insurance Information Institute

Investment Performance

Investments are the Principle Source of Declining Profitability

Property/Casualty Insurance Industry Investment Gain:1994- 2009:H1[1]

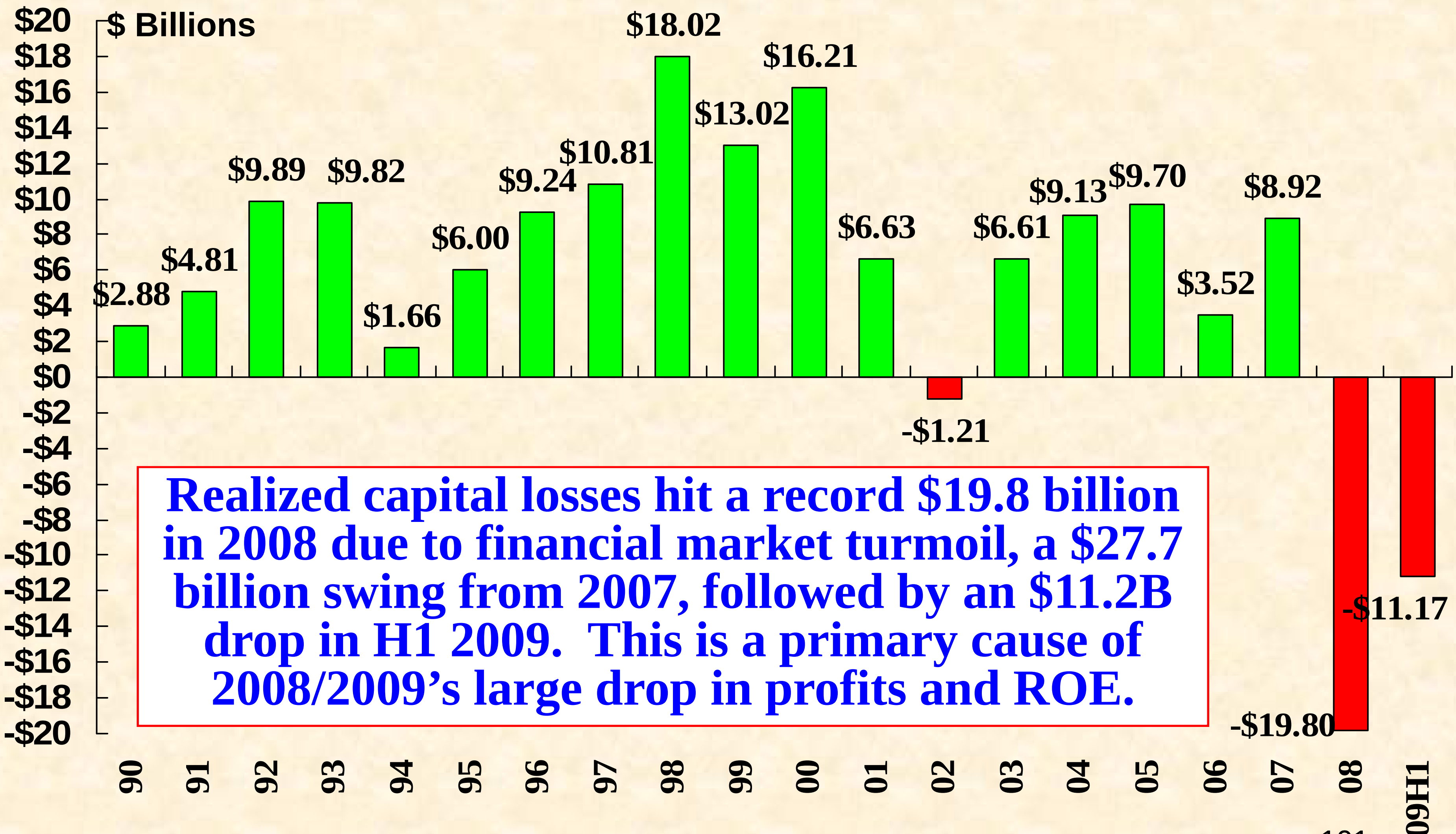


[1]Investment gains consist primarily of interest, stock dividends and realized capital gains and losses. 2006 figure consists of $52.3B net investment income and $3.4B realized investment gain.

*2005 figure includes special one-time dividend of $3.2B.

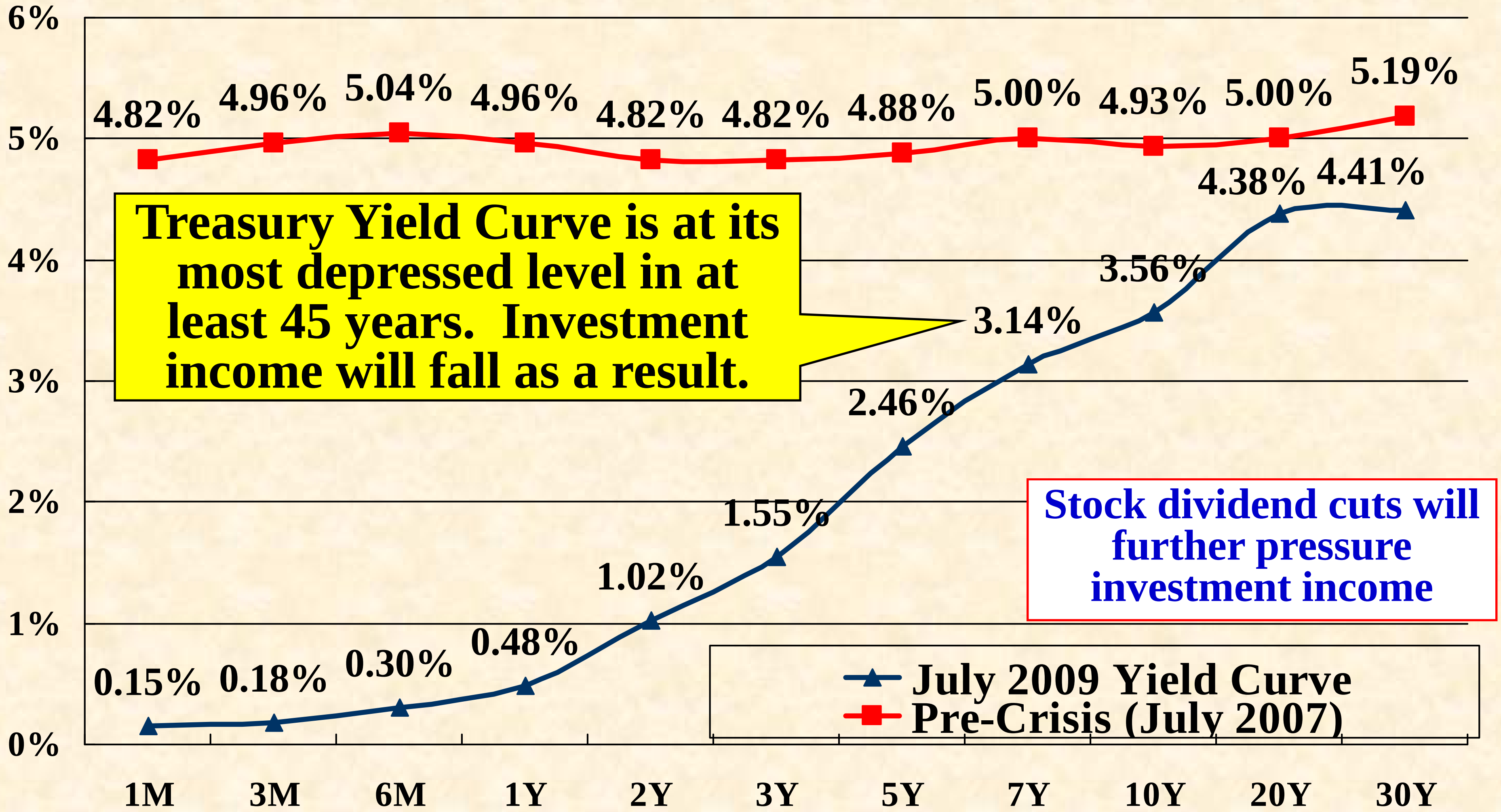
Sources: ISO; Insurance Information Institute.

P/C Insurer Net Realized Capital Gains, 1990-2009:Q1



Sources: A.M. Best, ISO, Insurance Information Institute.

Treasury Yield Curves: Pre-Crisis (July 2007) vs. July 2009



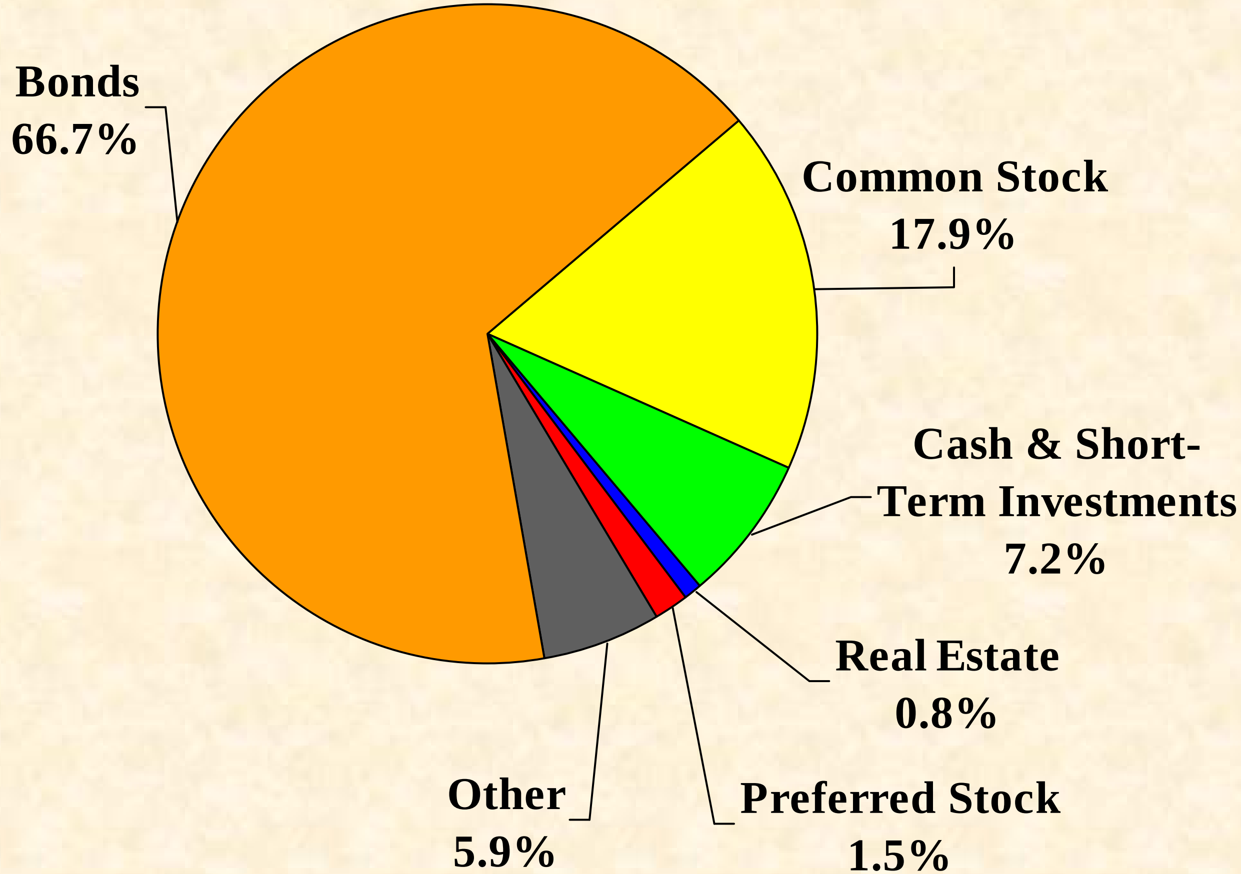
Sources: Board of Governors of the United States Federal Reserve Bank; Insurance Information Institute.

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2007

Portfolio Facts

- Invested assets totaled $1.3 trillion as of 12/31/07
- Insurers are generally conservatively invested, with 2/3 of assets invested in bonds as of 12/31/07
- Only about 18% of assets were invested in common stock as of 12/31/07
- Even the most conservative of portfolios was hit hard in 2008



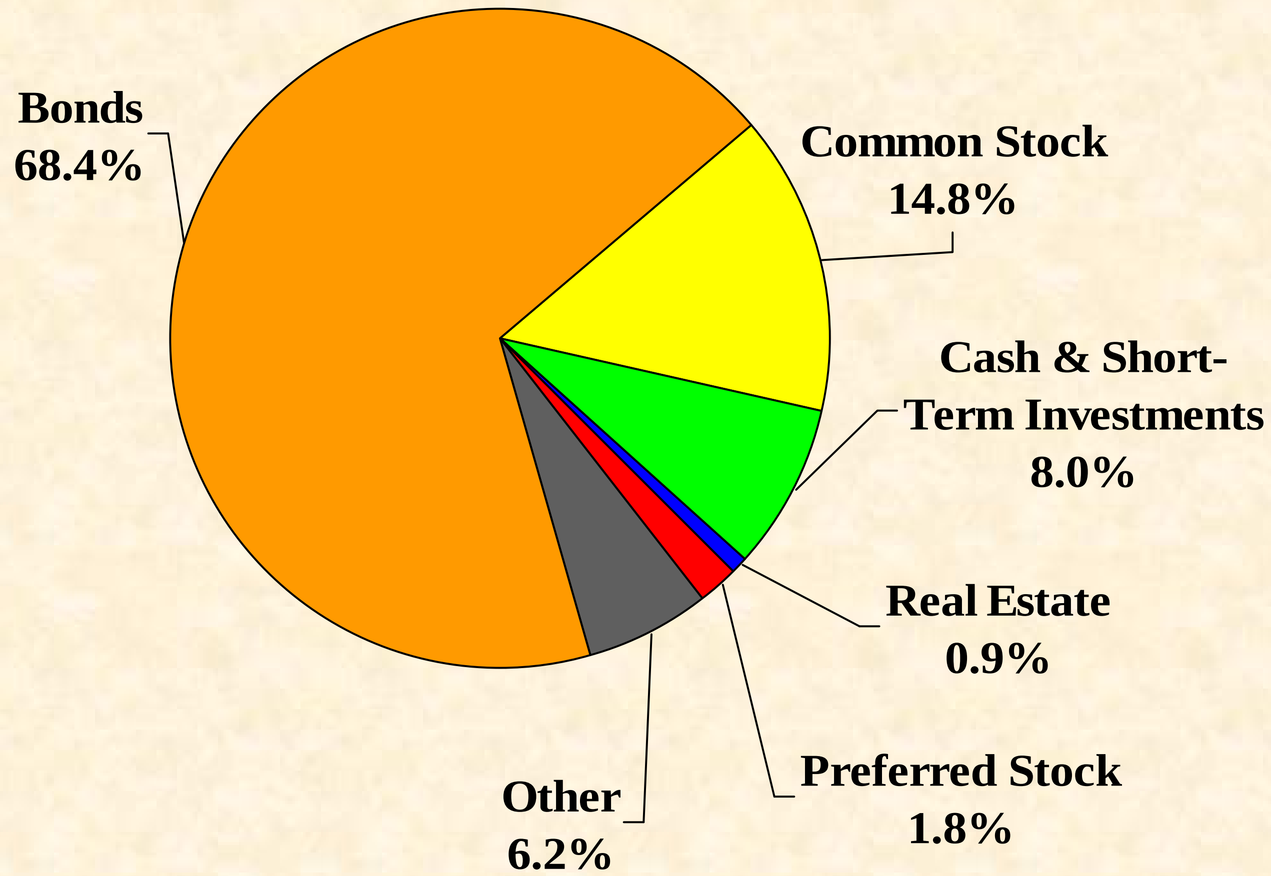
Source: NAIC; Insurance Information Institute research;.

Distribution of P/C Insurance Industry's Investment Portfolio

As of December 31, 2008

Portfolio Facts

- Invested assets totaled $1.2 trillion as of 12/31/08, down from $1.3 trillion as of 12/31/07
- Insurers are generally conservatively invested, with 2/3+ of assets invested in bonds as of 12/31/08
- Only about 15% of assets were invested in common stock as of 12/31/08, down from 18% one year earlier
- Even the most conservative of portfolios were hit hard in 2008

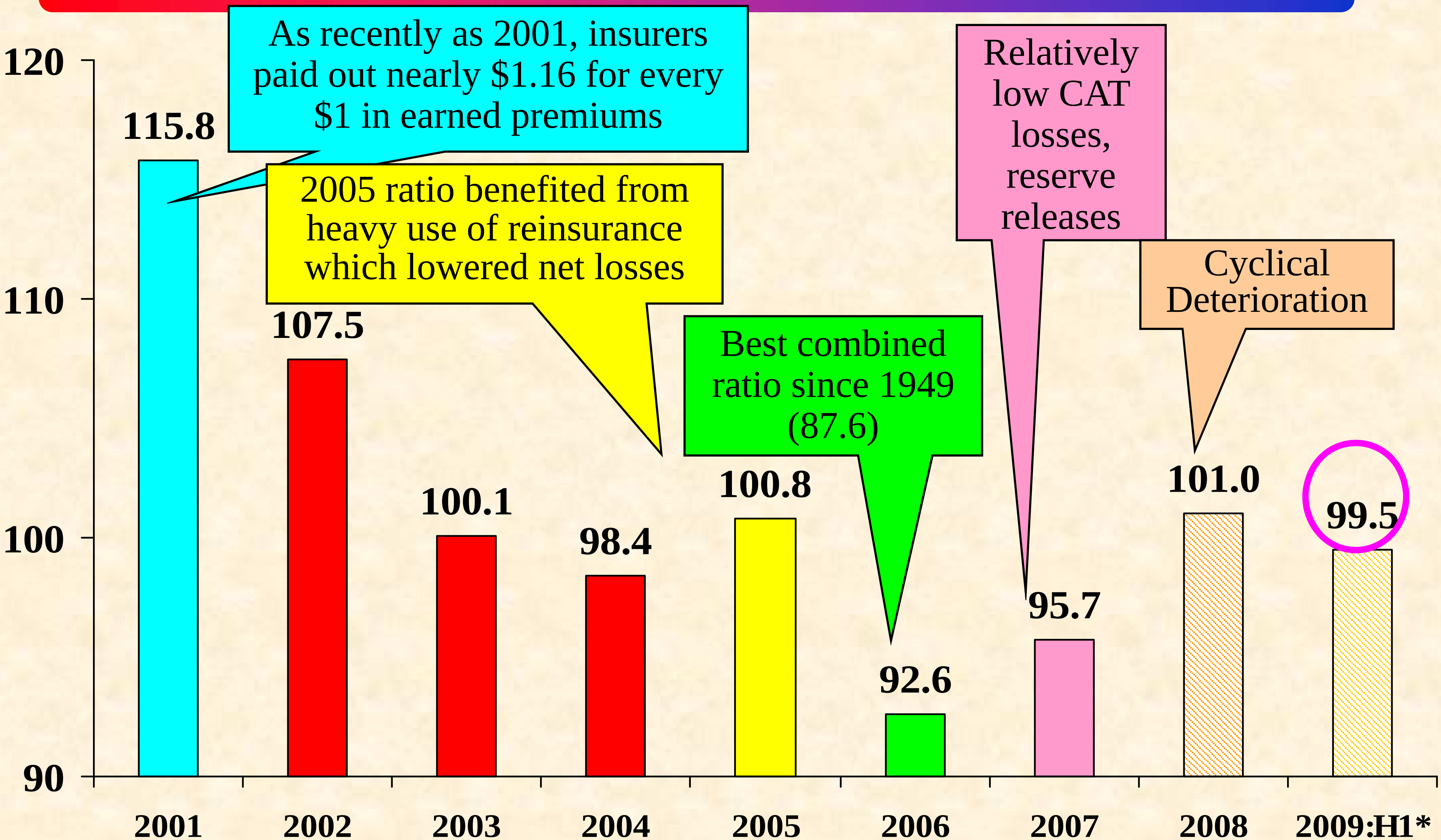


Source: NAIC; Insurance Information Institute research;.

Underwriting Trends

Financial Crisis Does ***Not*** Directly Impact Underwriting Performance: Cycle, Catastrophes Were 2008's Drivers

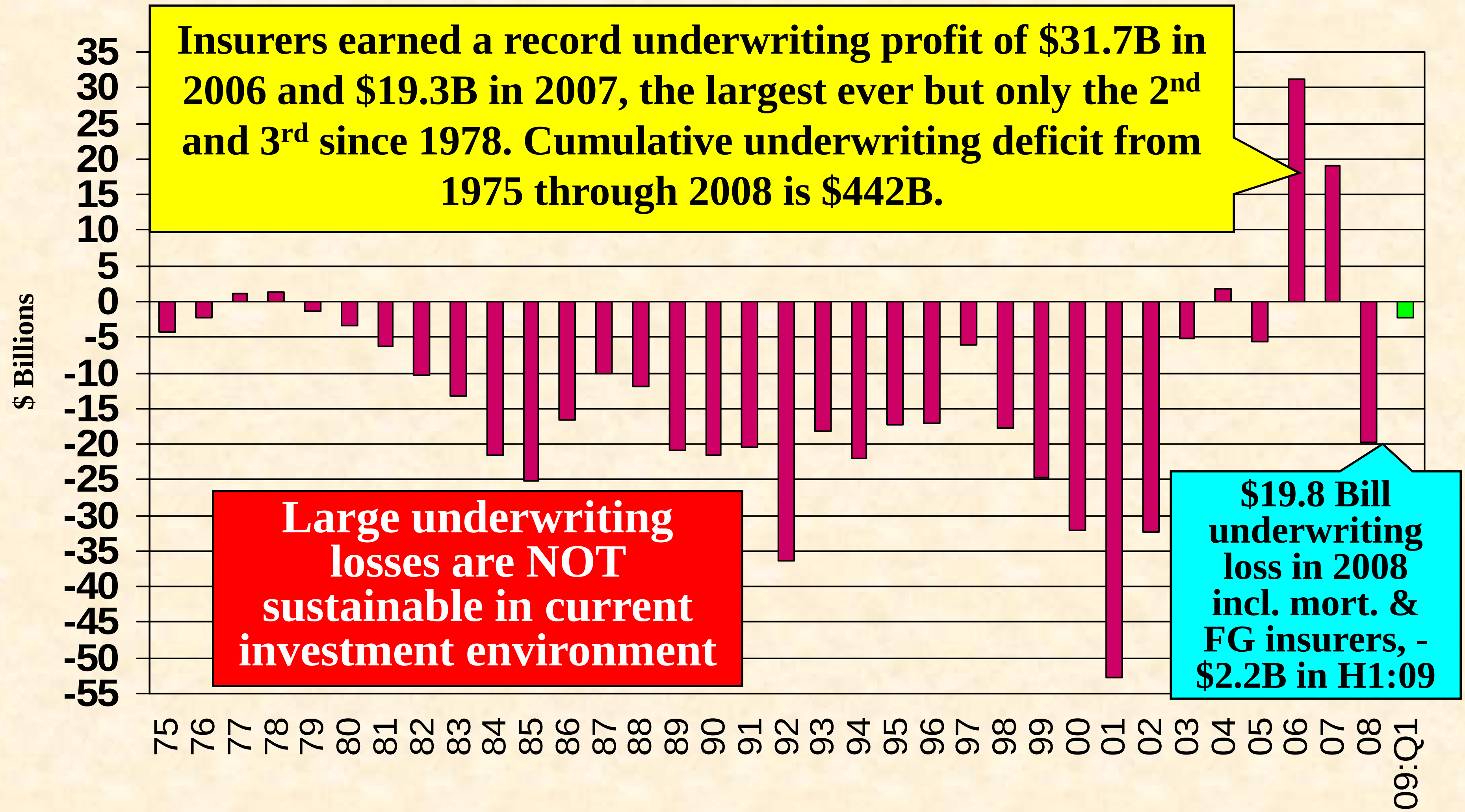
P/C Insurance Industry Combined Ratio, 2001-2009:H1*



*Excludes Mortgage & Financial Guaranty insurers in 2008. Including M&FG, 2008=105.1, 2009=100.9

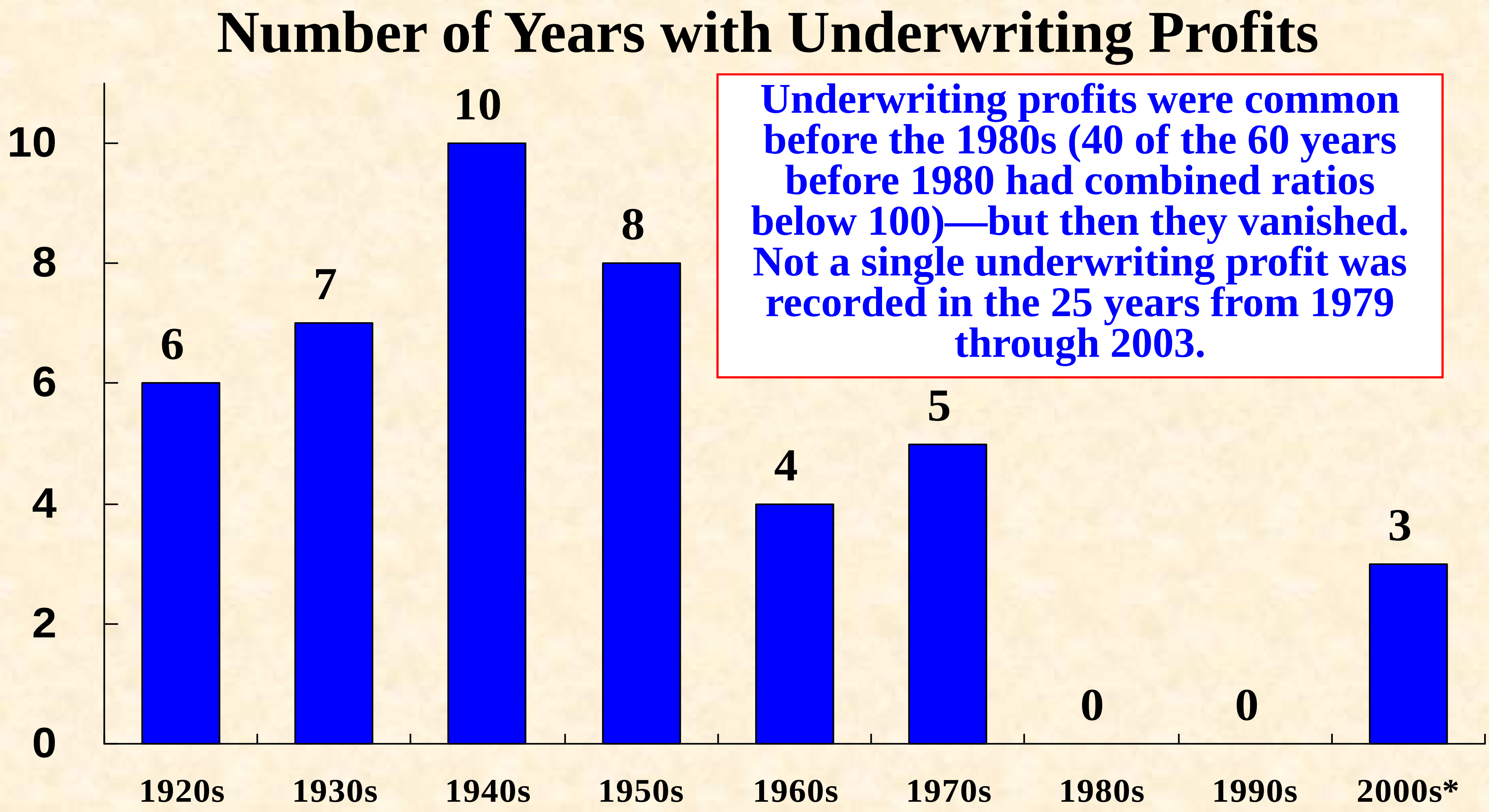
Sources: A.M. Best, ISO.

*Underwriting Gain (Loss) 1975-2009:H1**



Source: A.M. Best, ISO; Insurance Information Institute *** Includes mortgage & finl. guarantee insurers**

Number of Years With Underwriting Profits by Decade, 1920s –2000s



Note: Data for 1920 – 1934 based on stock companies only.

Sources: Insurance Information Institute research from A.M. Best Data.

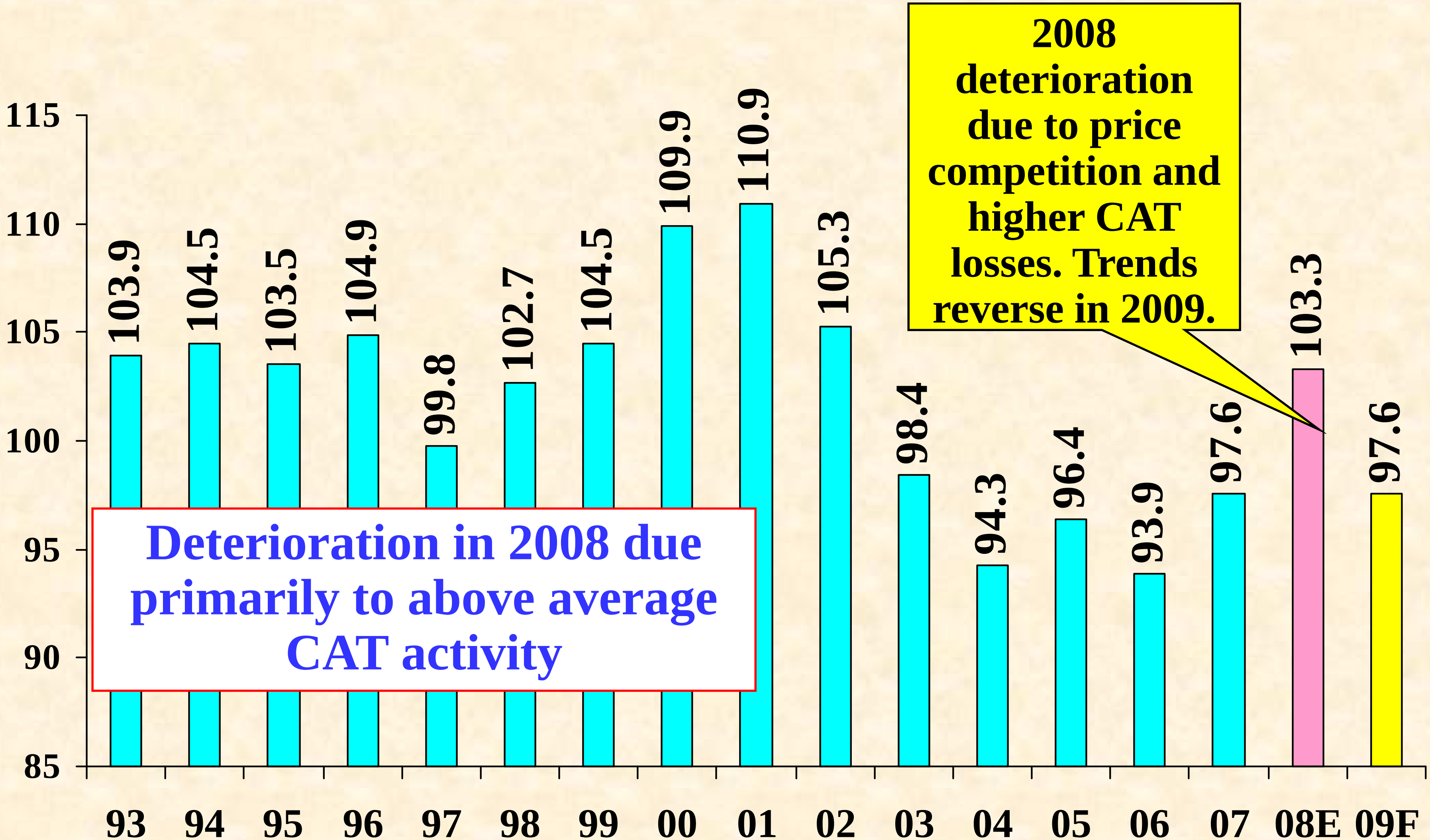
*2000 through 2008.

Personal Lines

Auto (~75% of Market)

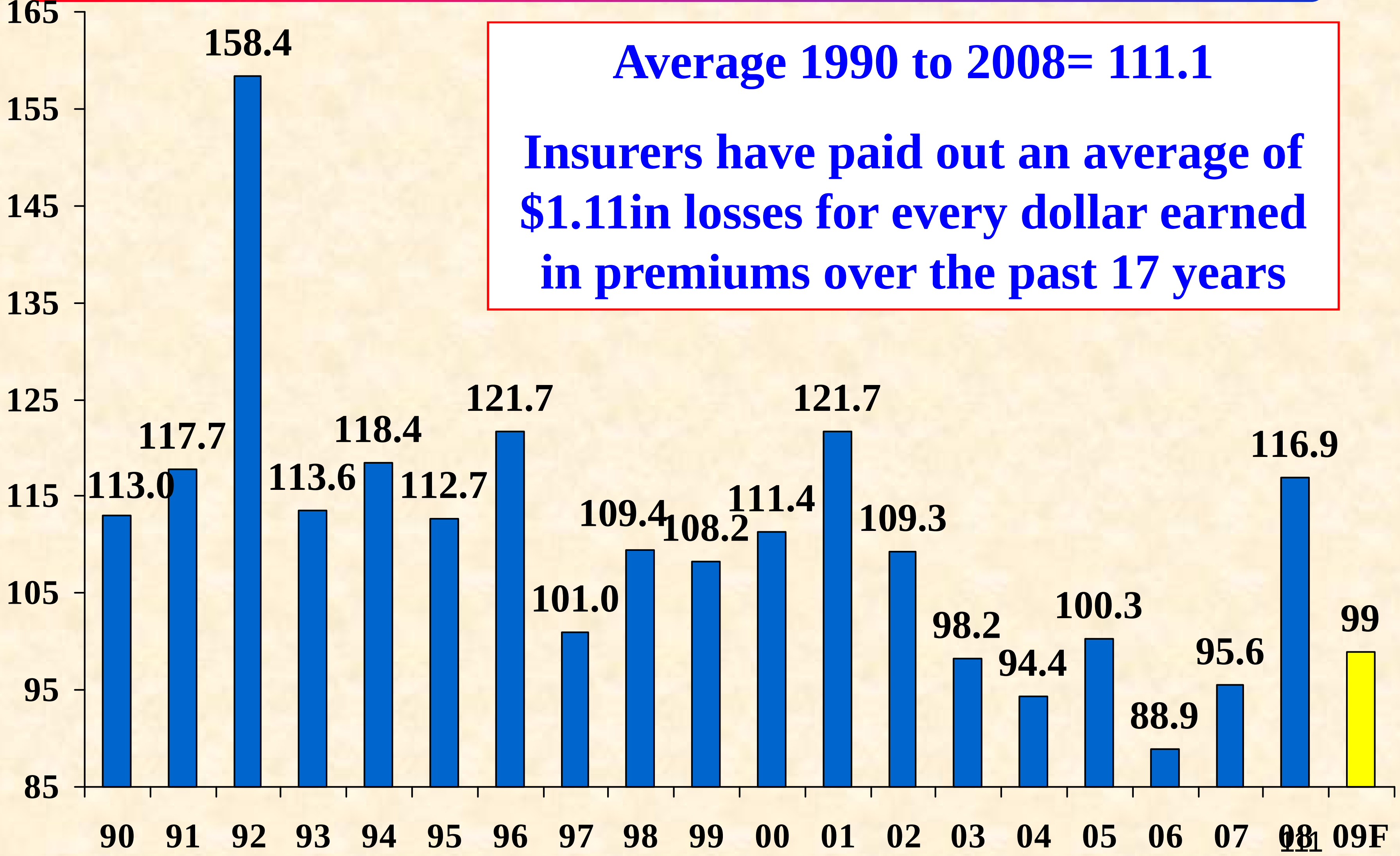
Home (~25%)

Personal Lines Combined Ratio, 1993-2008



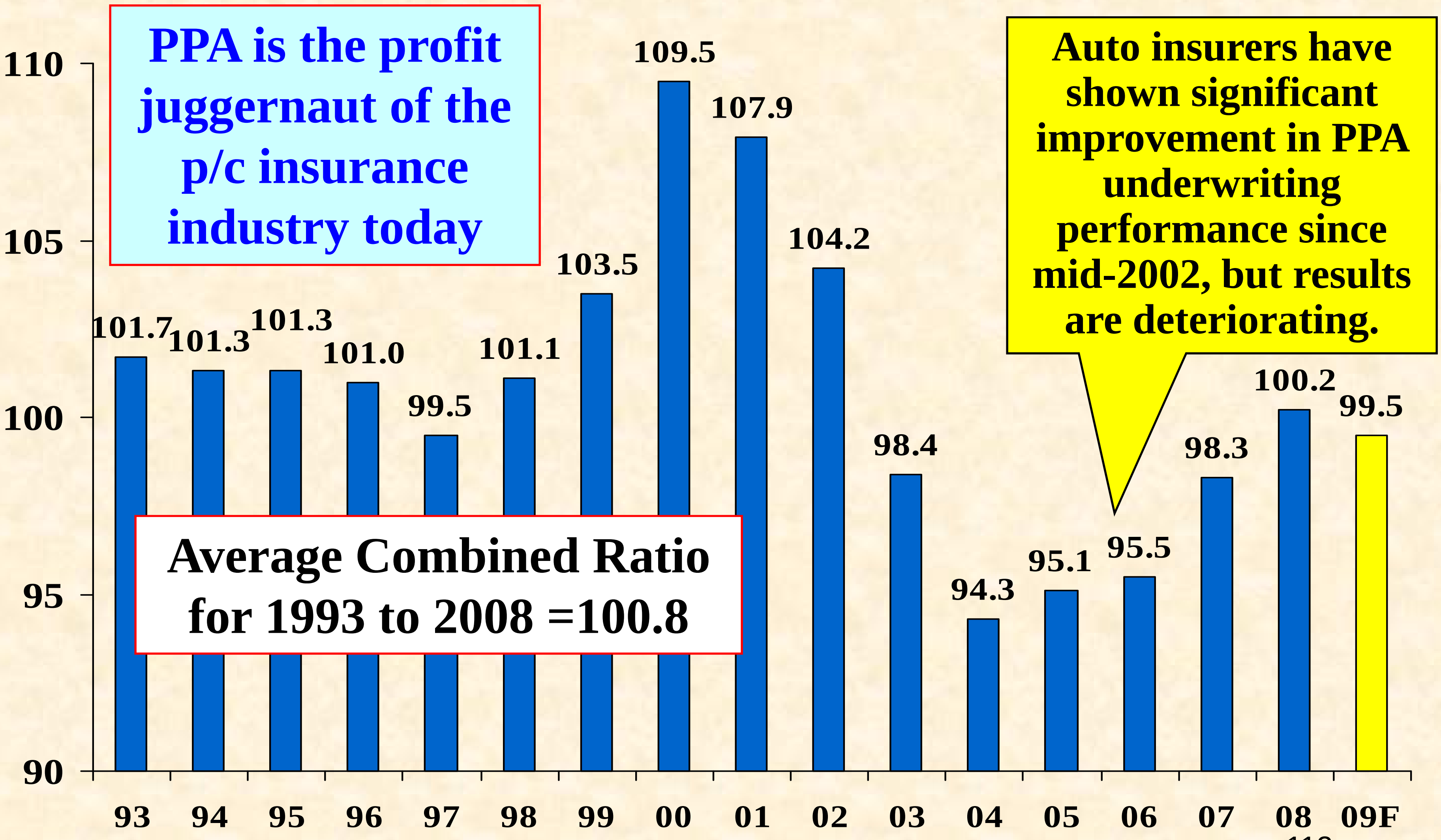
Source: A.M. Best (historical and forecast).

Homeowners Insurance Combined Ratio



Sources: A.M. Best (historical); III forecast for 2009.

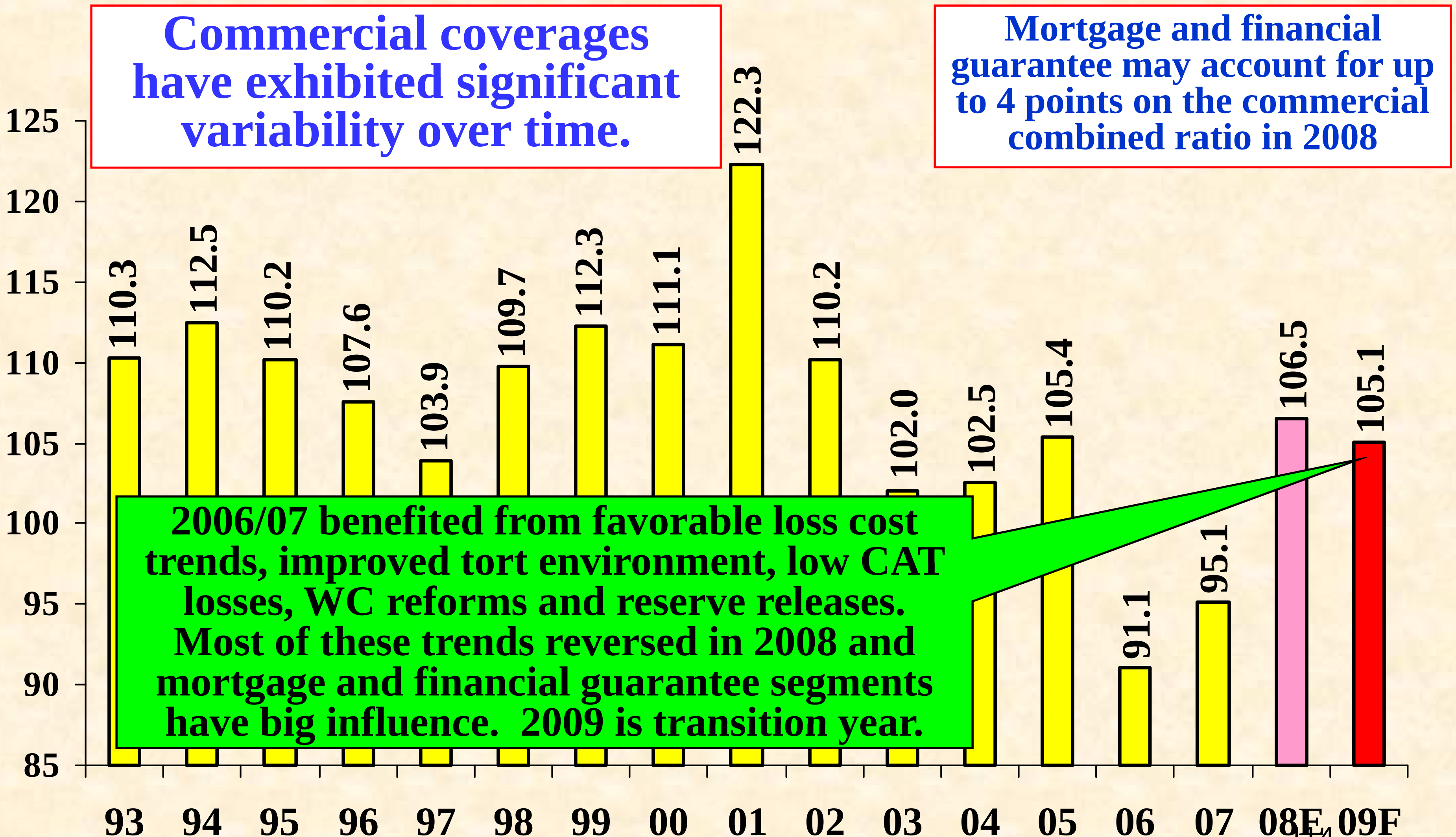
Private Passenger Auto (PPA) Combined Ratio



Sources: A.M. Best (historical); III forecast for 2009.

Commercial Lines

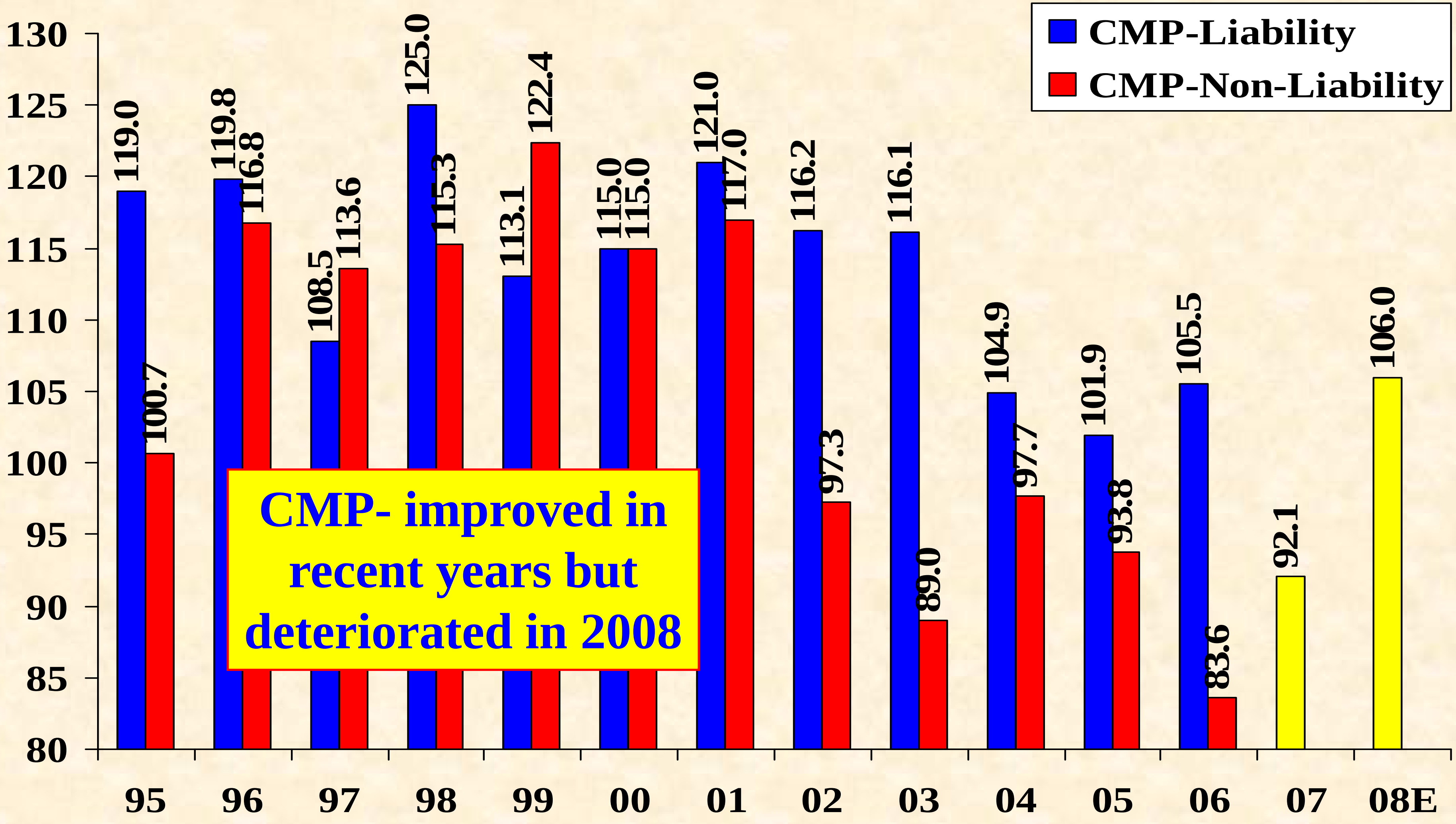
Commercial Lines Combined Ratio, 1993-2009F



Sources: A.M. Best (historical and forecasts)

Commercial Multi-Peril Combined

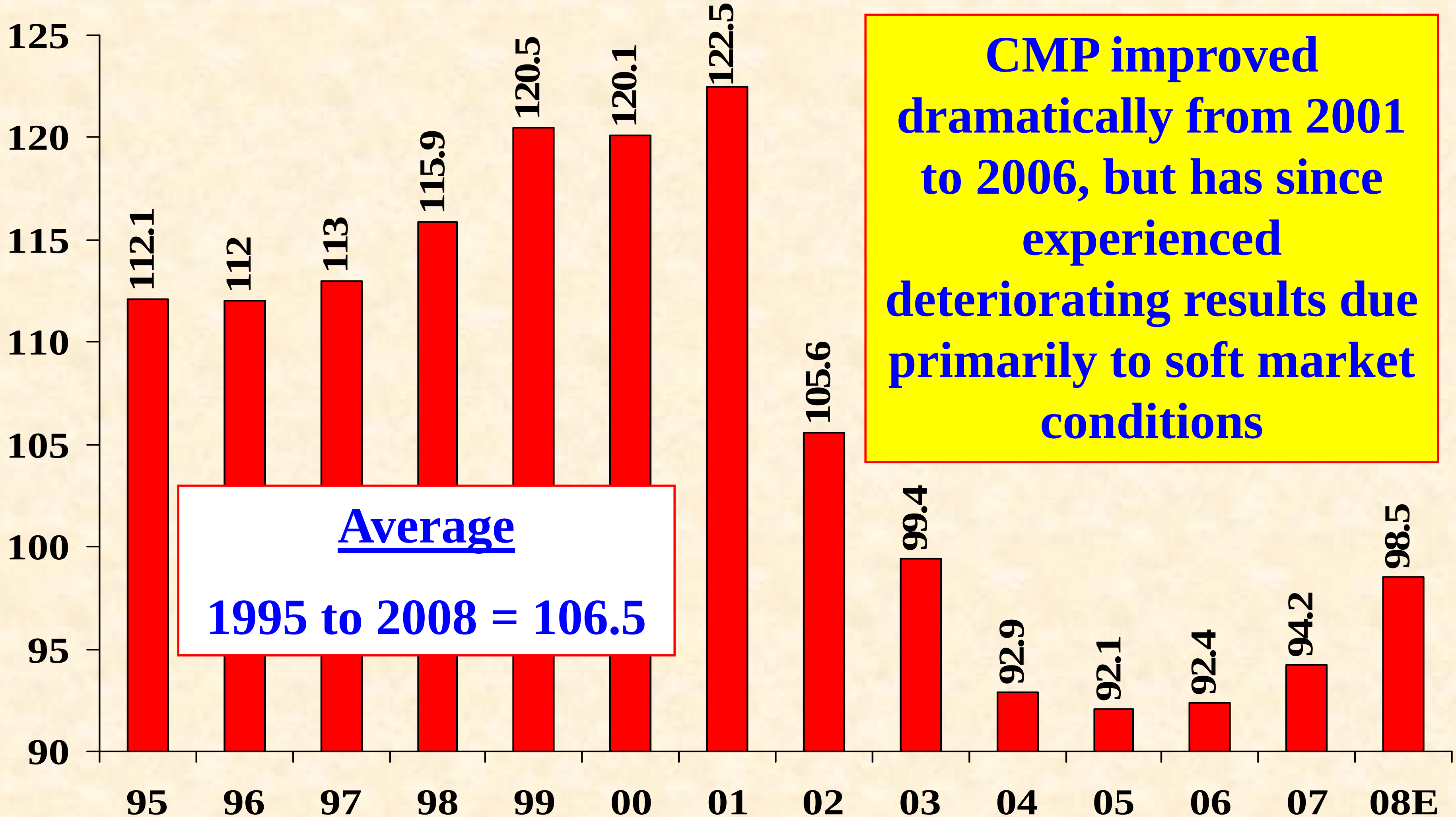
(Liability vs. Non-Liability Portion)*



Sources: A.M. Best

*Includes both liability and property damage for years 2007-2008.

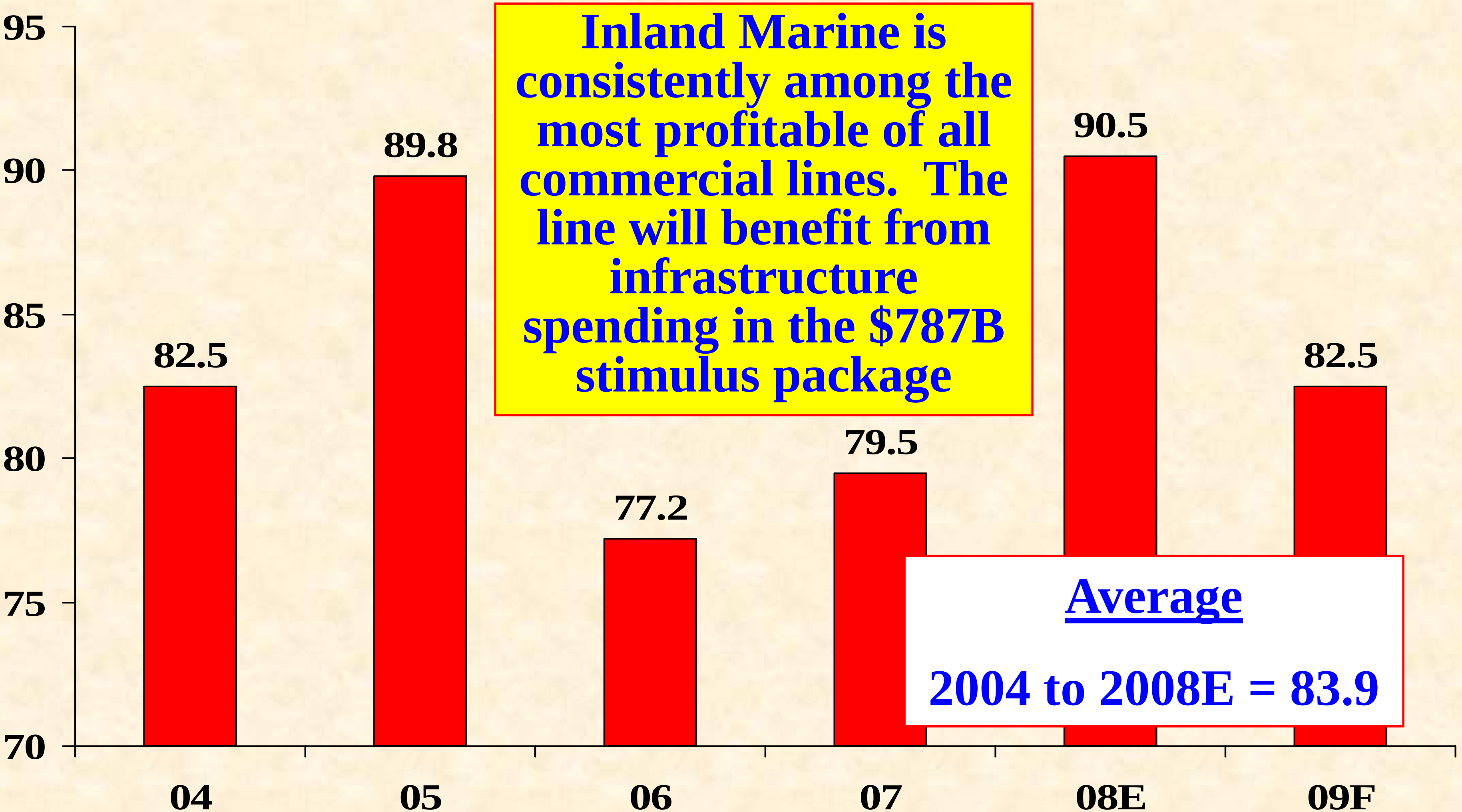
Commercial Auto Combined Ratio (1995-2008)



Sources: A.M. Best

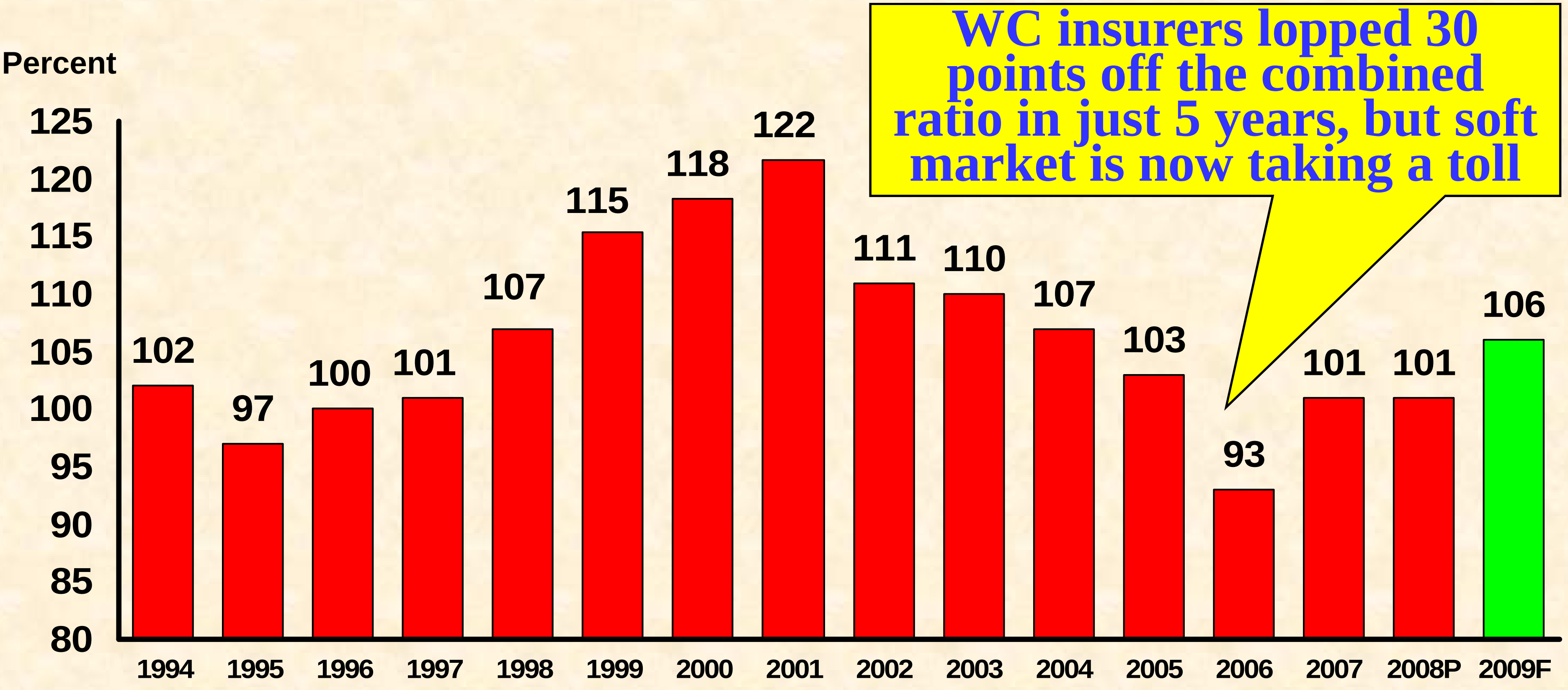
*Includes both liability and property damage.

Inland Marine Combined Ratio (2004-2009F)



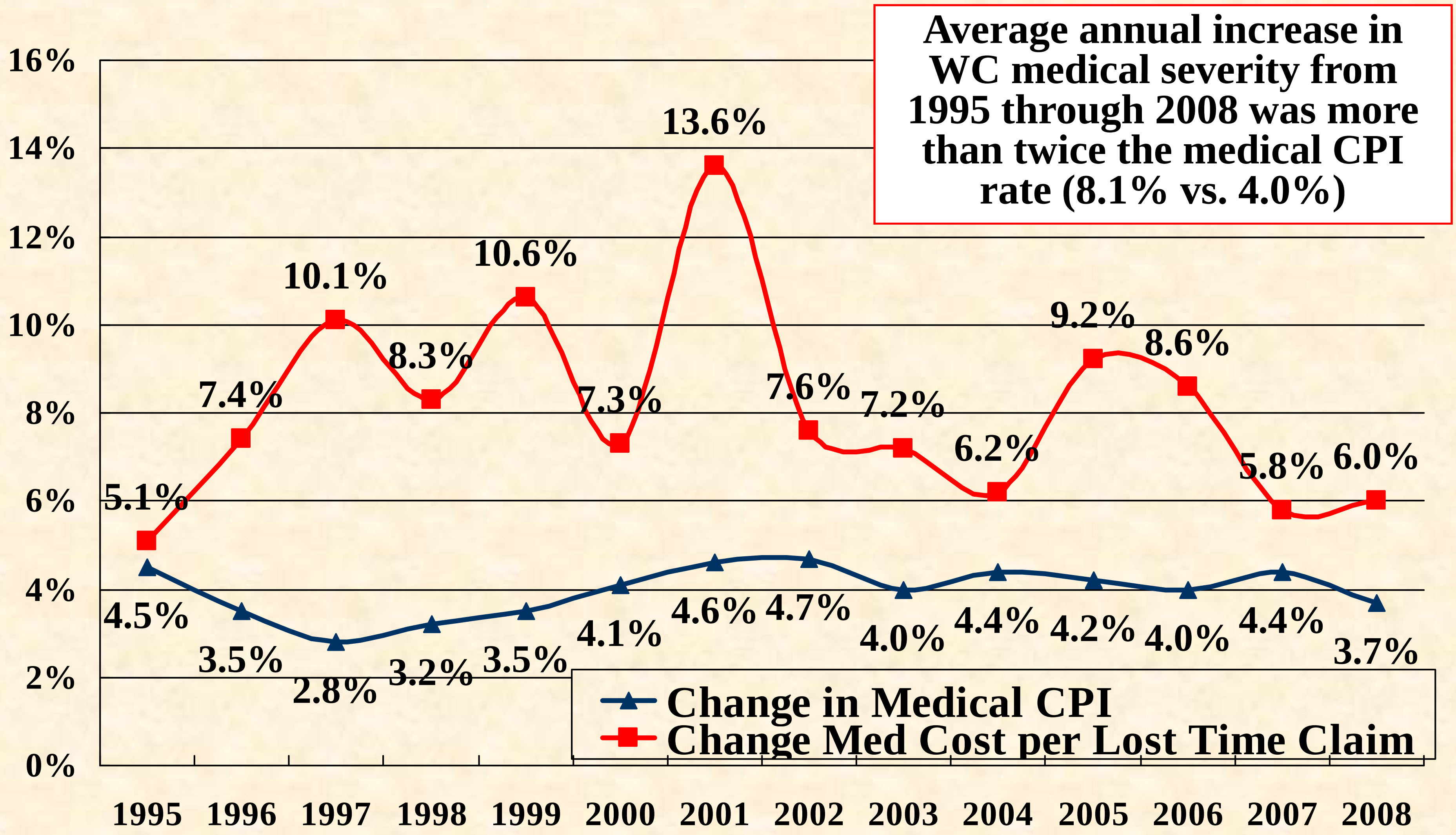
Sources: A.M. Best (historical and forecasts)

Workers Comp Combined Ratios,
(Calendar Year, Private Carriers) 1994-2009F



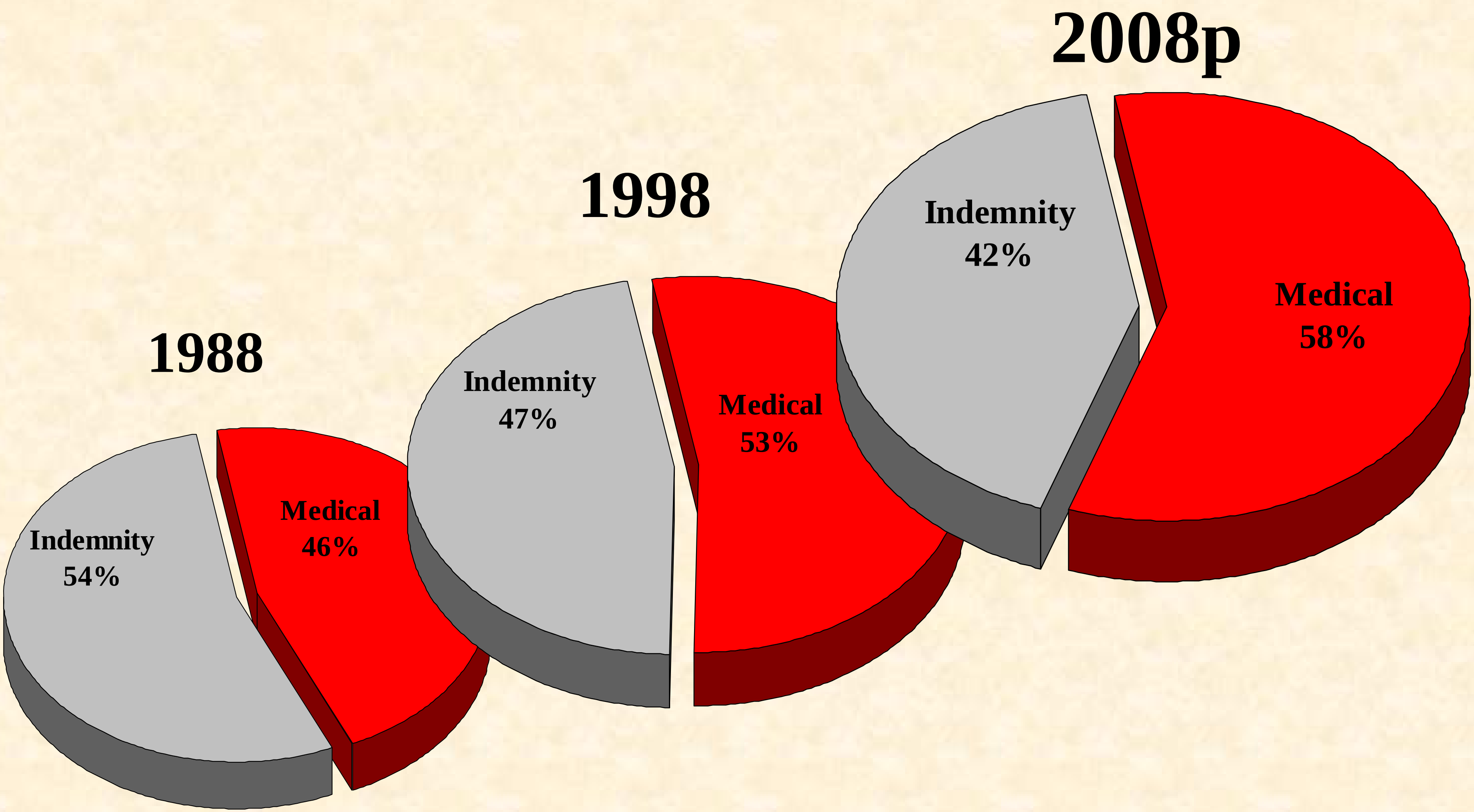
p Preliminary.
Sources: Calendar Years 1994-2008p, A.M. Best Aggregates & Averages; Calendar Year 2009F is I.I.I. estimates for private carriers based A.M. Best Review and Preview 2009; NCCI
Includes dividends to policyholders

WC Medical Severity Rising at Double the Medical CPI Rate



Sources: Med CPI from US Bureau of Labor Statistics, WC med severity from NCCI based on NCCI states.

Med Costs Share of Total Costs is Increasing Steadily

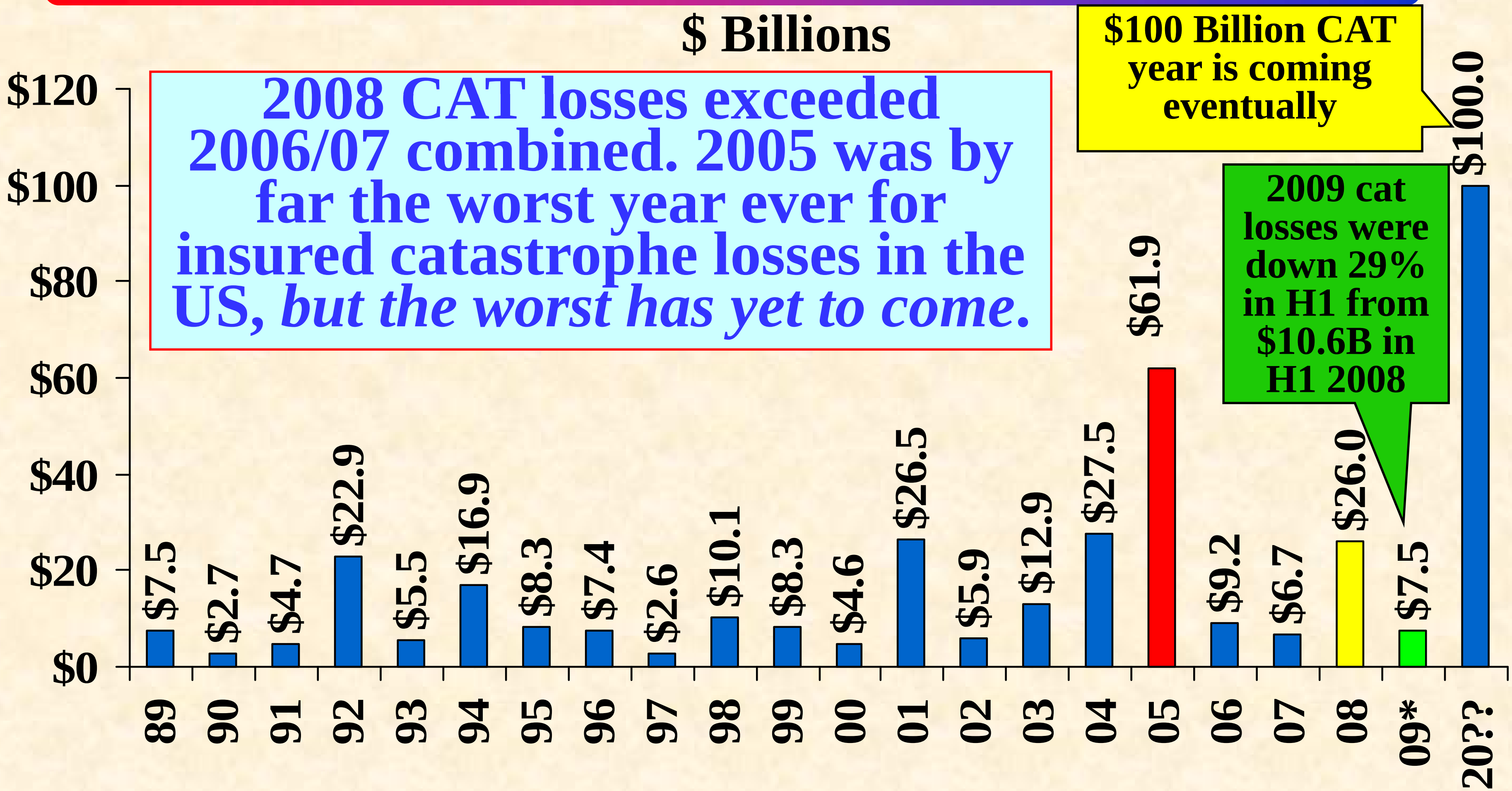


Source: NCCI (based on states where NCCI provides ratemaking services).

Catastrophic Loss

Catastrophe Losses Trends Are Trending Adversely

U.S. Insured Catastrophe Losses

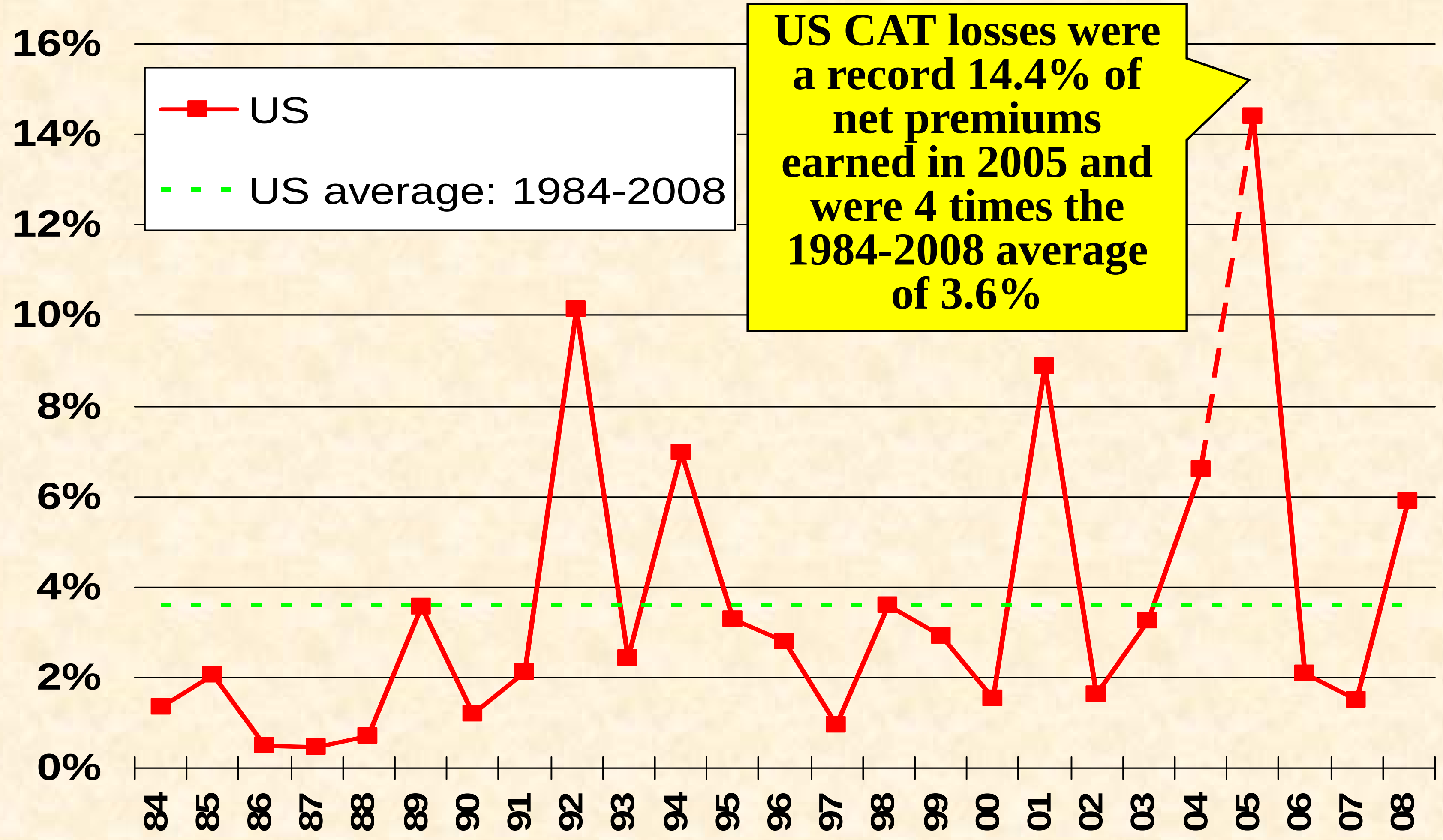


*Based on PCS data through June 30 = $7.5 billion.

Note: 2001 figure includes $20.3B for 9/11 losses reported through 12/31/01. Includes only business and personal property claims, business interruption and auto claims. Non-prop/BI losses = $12.2B.

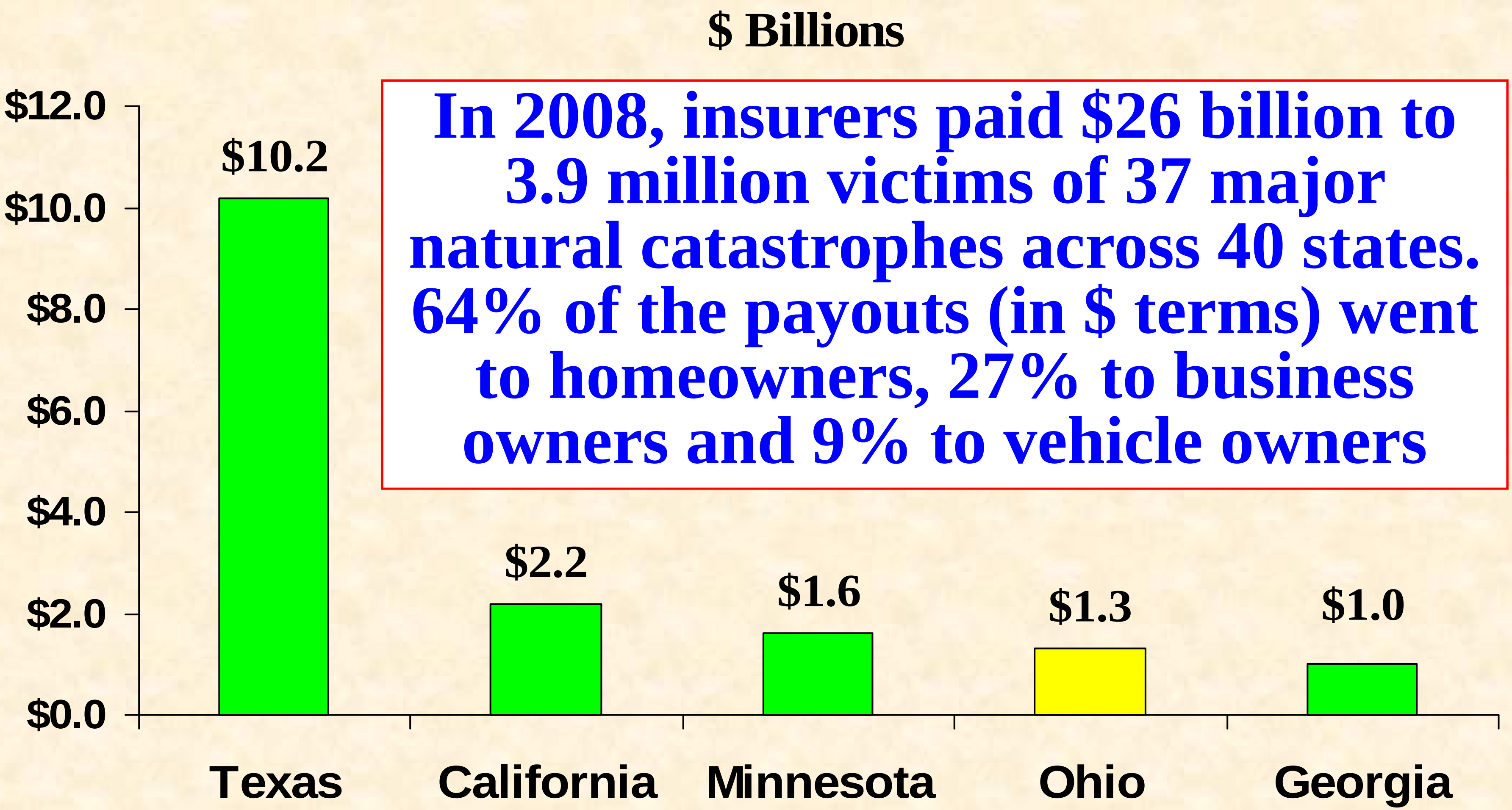
Source: Property Claims Service/ISO; Insurance Information Institute

Insured Property Catastrophe Losses as % Net Premiums Earned, 1984–2008



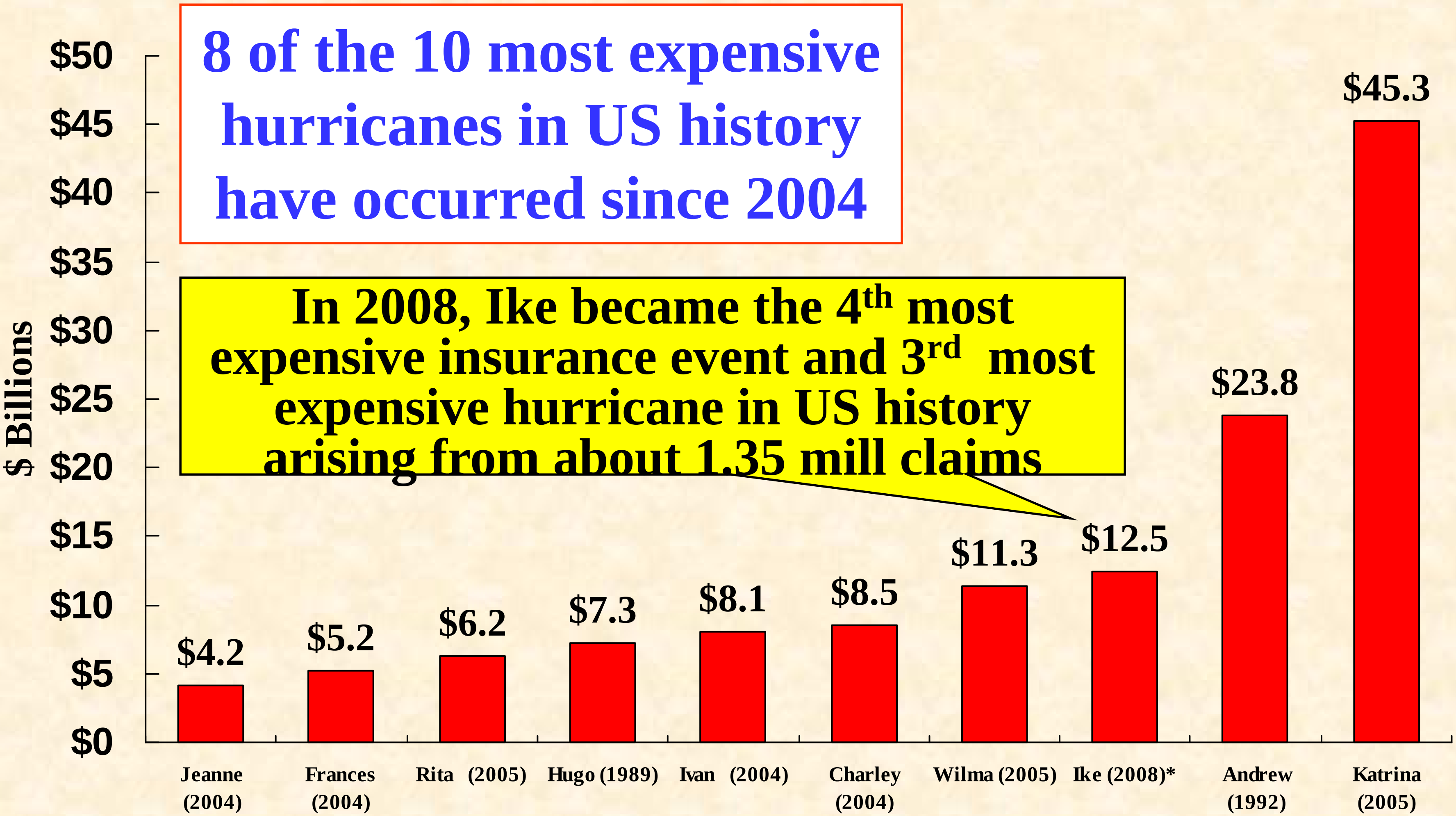
Sources: ISO, A.M. Best, Swiss Re Economic Research & Consulting; Insurance Information Institute.

States With Highest Insured Catastrophe Losses in 2008



Source: PCS; Insurance Information Institute.

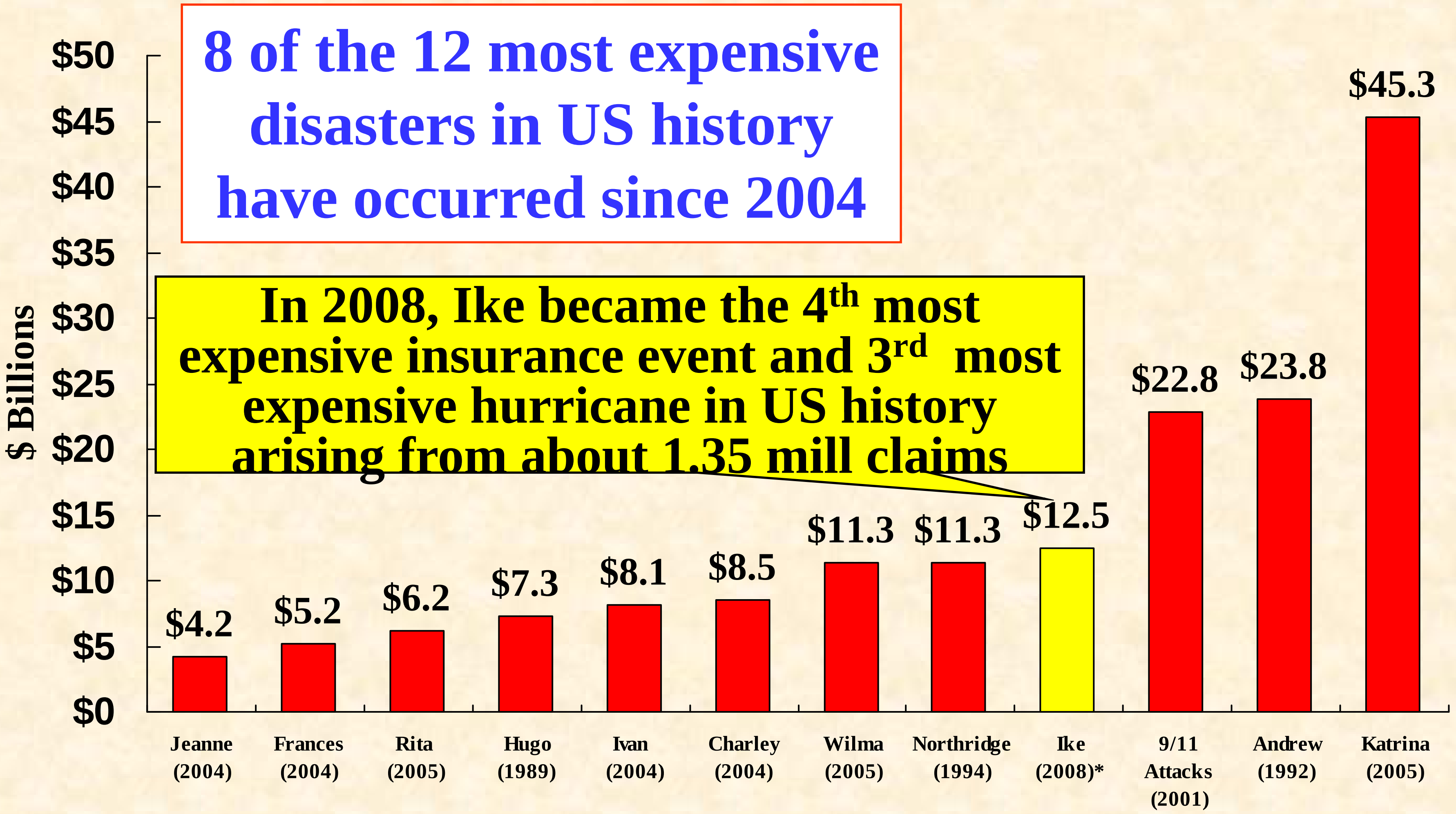
Top 10 Most Costly Hurricanes in US History, *(Insured Losses, $2008)*



*PCS estimate as of August 1, 2009.

Sources: PCS; Insurance Information Institute inflation adjustments.

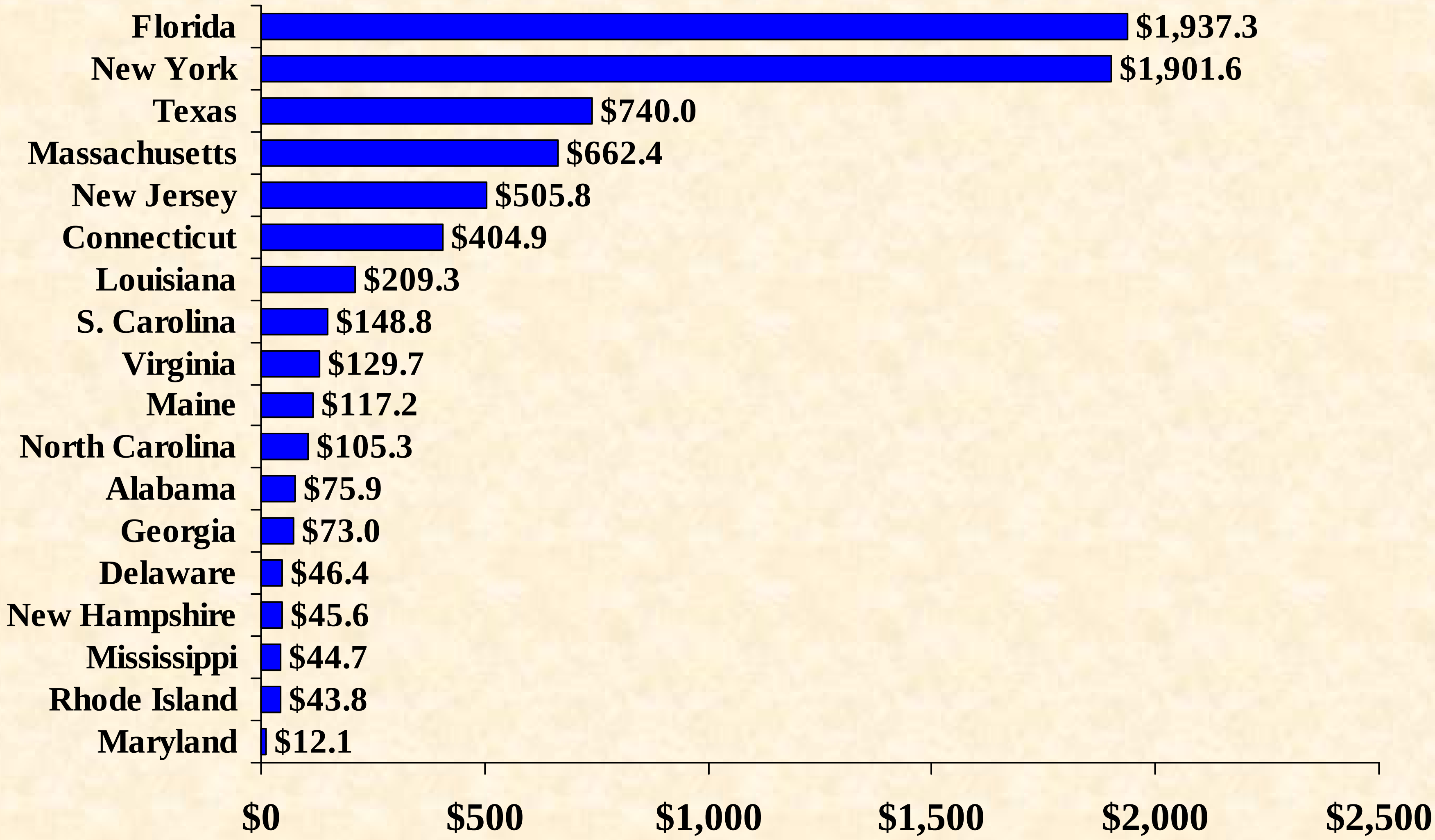
Top 12 Most Costly Disasters in US History, (Insured Losses, $2008)



***PCS estimate as of August 1, 2009.**

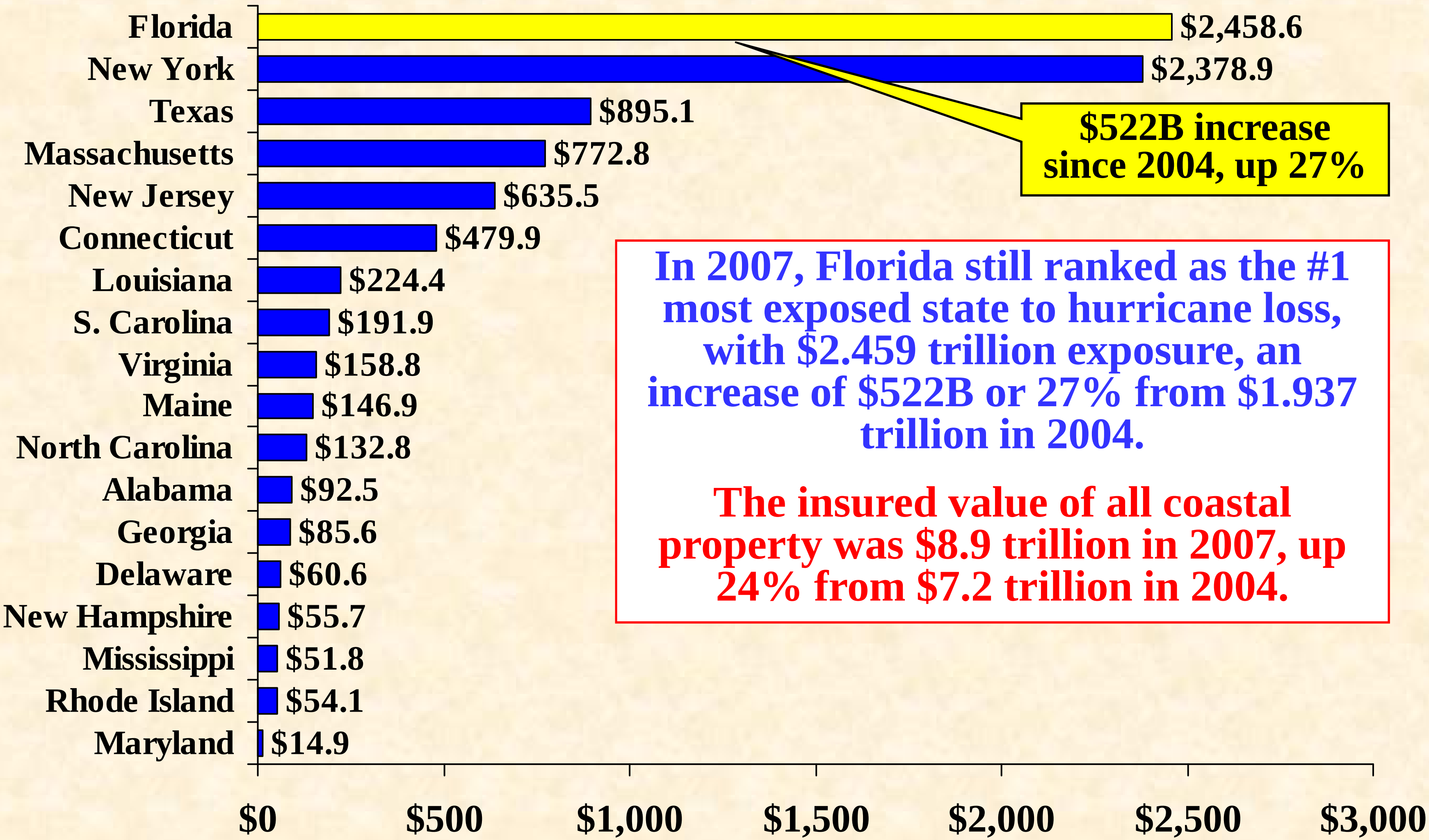
Sources: PCS; Insurance Information Institute inflation adjustments.

Total Value of Insured Coastal Exposure (2004, $ Billions)



Source: AIR Worldwide

Total Value of Insured Coastal Exposure *(2007, $ Billions)*

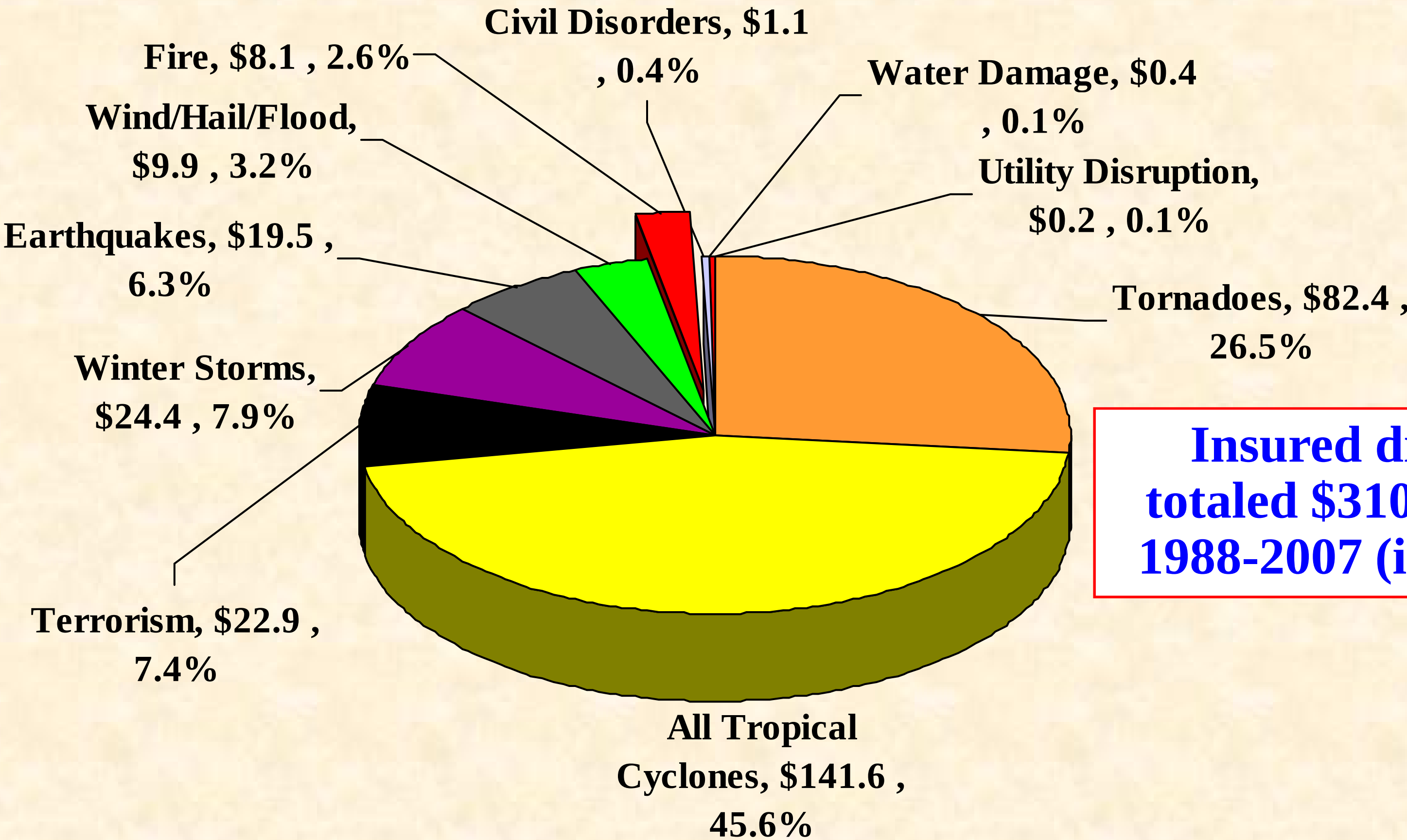


In 2007, Florida still ranked as the #1 most exposed state to hurricane loss, with $2.459 trillion exposure, an increase of $522B or 27% from $1.937 trillion in 2004.

The insured value of all coastal property was $8.9 trillion in 2007, up 24% from $7.2 trillion in 2004.

Source: AIR Worldwide

Inflation-Adjusted U.S. Insured Catastrophe Losses By Cause of Loss, 1988-2007[1]



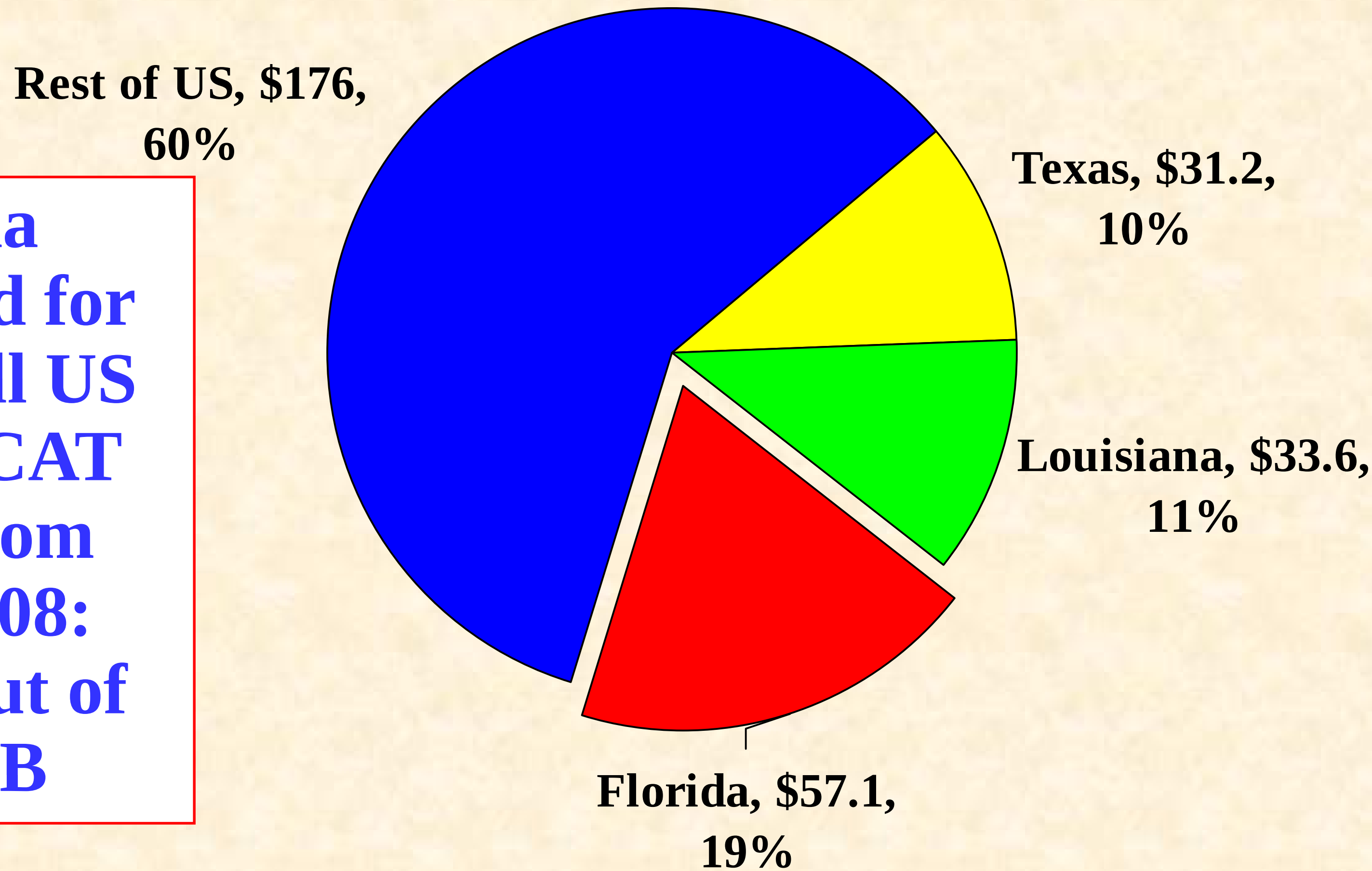
Insured disaster losses totaled $310.5 billion from 1988-2007 (in 2007 dollars)

[1] Catastrophes are all events causing direct insured losses to property of $25 million or more in 2007 dollars. Catastrophe threshold changed from $5 million to $25 million beginning in 1997. Adjusted for inflation by the III. [2] Excludes snow. [3] Includes hurricanes and tropical storms. [4] Includes other geologic events such as volcanic eruptions and other earth movement. [5] Does not include flood damage covered by the federally administered National Flood Insurance Program. [6] Includes wildland fires.

Source: Insurance Services Office (ISO)..

Distribution of US Insured CAT Losses: TX, FL, LA vs US, 1980-2008*

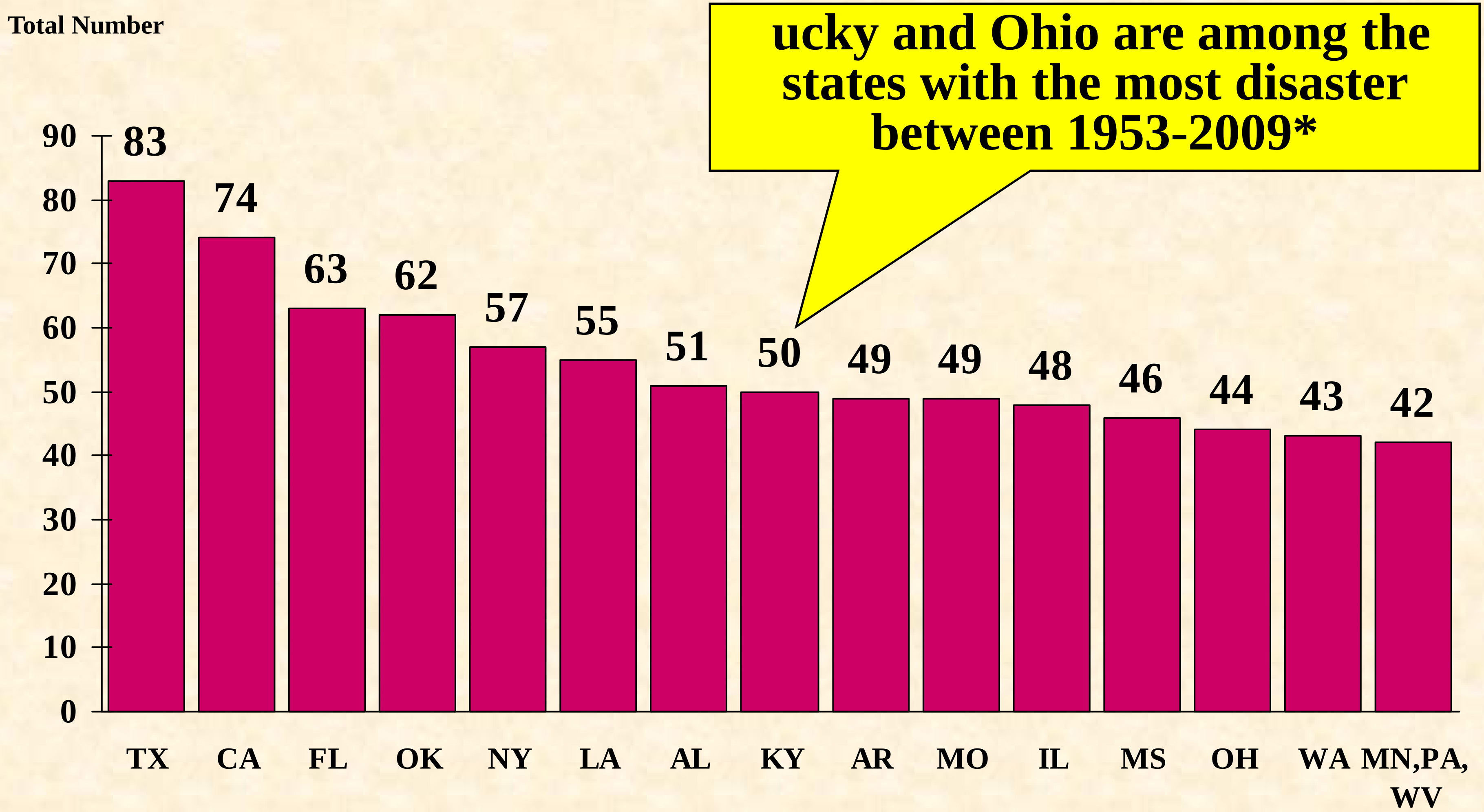
$ Billions of Dollars



Florida accounted for 19% of all US insured CAT losses from 1980-2008: $57.1B out of $297.9B

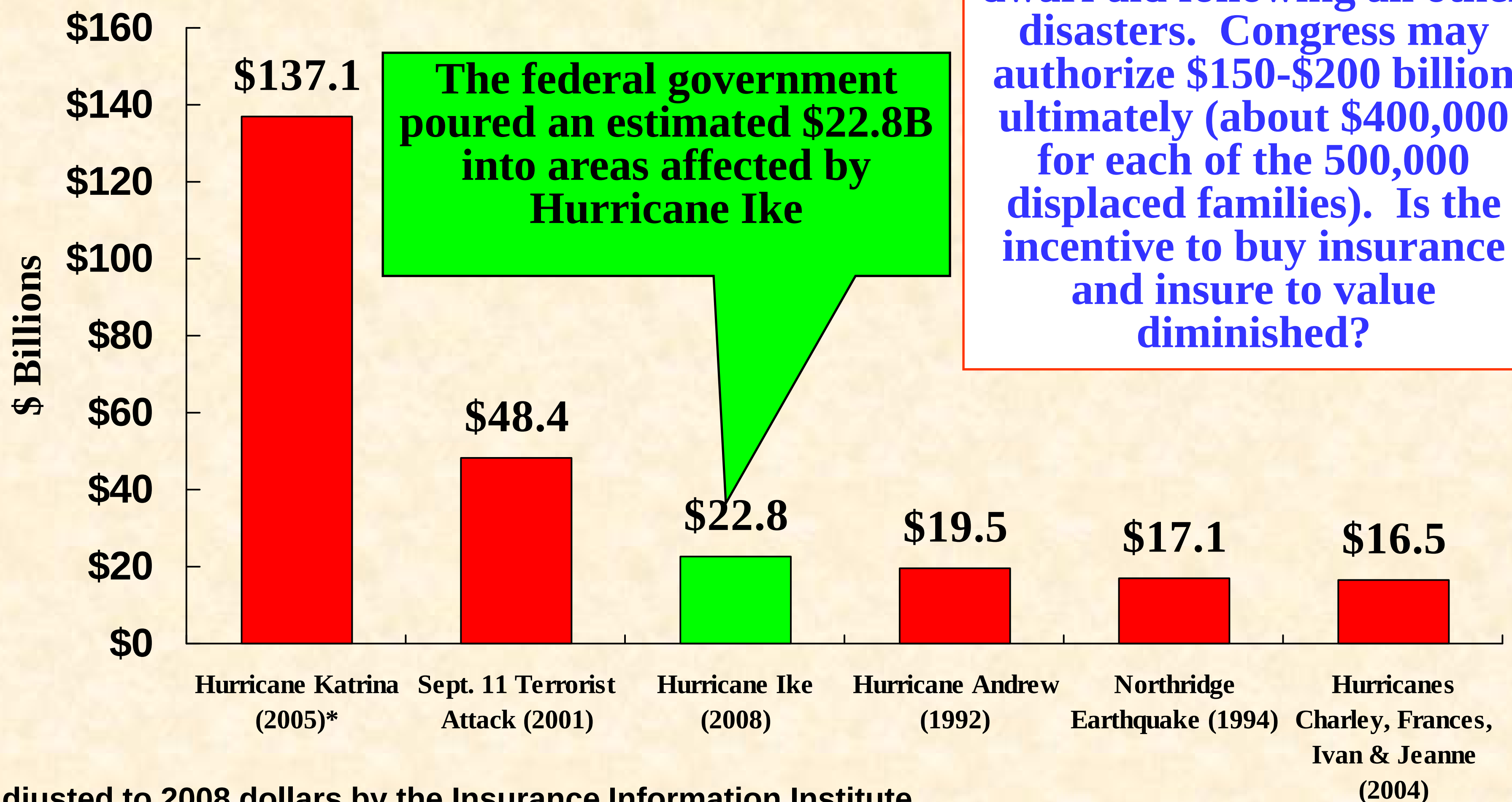
*All figures (except 2006-2008 loss) have been adjusted to 2005 dollars.
Source: PCS division of ISO.

Top 10 Major Disaster Declaration Totals By State: 1953- 2009*



*Through July 2, 2009.
Source: Federal Emergency Management Agency (FEMA)

Government Aid After Major Disasters (Billions)*



Hurricane Katrina aid will dwarf aid following all other disasters. Congress may authorize $150-$200 billion ultimately (about $400,000 for each of the 500,000 displaced families). Is the incentive to buy insurance and insure to value diminished?

***Adjusted to 2008 dollars by the Insurance Information Institute.**

Source: United States Senate Budget Committee, Insurance Information Institute as of 12/31/05; Houston Chronicle, 09/24/08 for Ike.

Summary

- **P/C Insurance Industry Has Weathered the Financial Crisis Better Than Most Financial Services Segments**
- **Lingering Effects of Soft Market and Weak Economy Have Kept Commercial Premium Growth in Negative Territory**
- **Recovery of Economy in 2010 Should Begin to Help Commercial Insurers Realize Exposure Growth**
  - **Growth trajectory likely to be slow and uneven across states**
- **Investment Performance Should Improve Modestly, but Disciplined Underwriting Gains in Importance**
- **Industry Can Be Profitable in Period of Slow Growth**

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